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MAINSTORMING 2020

ECONOMY & INFRASTRUCTURE II

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MAINSTORMING 2020

ECONOMICS & INFRASTRUCTURE II

(SEPTEMBER 2020 TO NOVEMBER 2020)

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1. GROWTH AND DEVELOPMENT

1.1 GDP Contraction

Why in news?

The Ministry of Statistics and Programme Implementation (MoSPI) released the data for the first quarter (Q1) of the current financial year.

What does the data reveal?

- Most observers expected that India's GDP contraction would not exceed 20% in the first quarter (April, May, June).
- [GDP - Final value of the goods and services produced within the geographic boundaries of a country during a specified period of time.]
- As it turns out, the GDP contracted by 24% in Q1.
- Almost all the major indicators of growth in the economy - production of cement or consumption of steel - show deep contraction.
- The data quality is sub-optimal because of the widespread lockdowns.
- Most observers expect this number to worsen when it is revised in due course.

What is the biggest implication?

- With GDP contracting by more than what most observers expected, it is now believed that the full-year GDP could also worsen.
- Since economic liberalisation in the early 1990s, Indian economy has clocked an average of 7% GDP growth each year.
- This year, it is likely to turn turtle and **contract by 7%** for the full financial year.
- Data show that barring agriculture, where the gross value added (GVA) grew by 3.4%, all other sectors of the economy saw their incomes fall.
- [GVA - A proxy for production and incomes]
- The worst affected were construction (–50%), trade, hotels and other services (–47%), manufacturing (–39%), and mining (–23%).
- It is important to note that these are the sectors that create the maximum new jobs in the country.
- In a scenario where each of these sectors is contracting so sharply, it would lead to a decline in employment or rise in unemployment.

What causes GDP contraction?

- In any economy, the total demand for goods and services i.e., the GDP is generated from one of the **four engines of growth**.
- The biggest engine is consumption demand from private individuals (C).
- In India, this accounted for 56.4% of all GDP before this quarter.

- The second biggest engine is the demand generated by private sector businesses (I) and this accounted for 32% of all GDP in India.
- The third engine is the demand for goods and services generated by the government (G), and it accounted for 11% of India's GDP.
- The last engine is the net demand on GDP after we subtract imports from India's exports (NX).
- In India's case, it is the smallest engine and, since India typically imports more than it exports, its effect is negative on the GDP.
- So total GDP = C + I + G + NX

How did these engines perform?

- Private consumption has fallen by 27%.
- The demand generated by private sector businesses has fallen even harder - it is half of what it was last year same quarter.
- So the two biggest engines, which accounted for over 88% of Indian total GDP, saw a massive contraction in the Q1.
- The NX has turned positive in this Q1 because India's imports have crashed more than its exports.
- The last engine of growth, government's expenditure went up by 16%
- But this was nowhere near enough to compensate for the loss of demand (power) in other sectors (engines) of the economy.
- The government spending increased meagrely that it could cover just 6% of the total fall in demand being experienced by people and businesses.
- It is the lower level of absolute GDP that is making the government look like a bigger engine of growth than what it is.

What is the way out?

- When incomes fall sharply, private individuals cut back consumption.
- When private consumption falls sharply, businesses stop investing.
- Since both are voluntary decisions, there is no way to force people to spend more and/or coerce businesses to invest more in the current scenario.
- The same logic holds for exports and imports as well.
- Under the circumstances, there is only one engine that can boost GDP and that is the government (G).
- Only when government spend more, can the economy revive in the short to medium term.

What is holding back the government from spending more?

- Even before the Covid crisis, government finances were overextended.
- It was not only borrowing but borrowing more than what it should have.
- As a result, today it doesn't have as much money.
- It will have to think of some innovative solutions to generate resources.

1.2 Growth Prospects

What is the issue?

- Global growth prospects for 2020 have been projected by many multilateral institutions and rating agencies including that for India.

- India's growth in the first quarter of 2020-21 at (-) 23.9% showed one of the highest contractions globally.

What are the forecasts for India?

- The 2020-21 real GDP growth is forecast in the range of (-) 5.8% (the RBI's Survey of Professional Forecasters) to (-) 14.8% (Goldman Sachs).
- The annual projections indicate a strong likelihood of the nominal GDP growth showing a contraction for 2020-21.

What does the latest data reveal?

- The latest data of the Ministry of Statistics indicate a Consumer Price Index (CPI) inflation rate of 6.7% for August 2020.
- Average CPI inflation during the first 5 months of 2020-21 is estimated at 6.6%.
- Given the injection of periodic liquidity into the system and the inflation trends, the year as a whole may show 7% CPI inflation.
- The contraction in nominal GDP would be -5.0% for 2020-21.

Why did some feel that the economy might not do too badly?

- There was a demand for health, relief and revival expenditures.
- Some thought that the key sectors such as agriculture and related sectors, public administration, defence services and others may have performed normally.
- Some had even expected that a small positive growth might be possible.
- The national income figures for Quarter I of 2020-21 hold no such hope.
- There was no fiscal stimulus.
- Independent estimates show that States' capital spending fell by 43.5%
- The worsening of the fiscal deficit appears to be because of **decline in revenue** than increase in expenditure.

Why would revenue contract?

- The policy challenge for the remaining part of the fiscal year is to **minimise the sharp contraction** in real and nominal growth.
- A sharp contraction in nominal GDP growth has adverse implications for the prospects of central and State tax revenues, which may both contract.
- The revenue calculations of the Budget were made on the assumption that the nominal income of the country would grow at 10%.
- With the prospect of a contraction in nominal growth, the Centre's tax revenues would show a huge shortfall as compared to the budgeted amounts.
- The combined fiscal deficit of the Centre and the States will have to make up for the shortfall in tax and non-tax revenues.

Why fiscal deficit needs to be increased?

- The central government should maintain the level of budgeted expenditure and also provide for additional stimulus.
- For this, its fiscal deficit may have to be increased to close to an estimated 8.8% of GDP.
- If one adds the Centre's and States' fiscal deficit, the combined fiscal deficit amounts to 13.8% of GDP.
- If the nominal GDP actually contracts in 2020-21, the fiscal deficit as the percent of GDP would go up further.

- This does not take into account any additionality to borrowing because of the Goods and Services Tax (GST) compensation.
- The Centre's fiscal during the first four months of 2020-21 as a per cent of annual budgeted target was at 103.1%.

How high can fiscal deficit go?

- The International Monetary Fund, in its 2020 World Economic Outlook, estimated the fiscal deficit of India and China at 12.1% of GDP.
- All the other countries except the United States and a few others have a deficit lower than this.
- There are not adequate resources to support India's fiscal deficit of nearly 14% of GDP.
- This will require support from the RBI which will have to take on itself, either directly or indirectly, a part of the central government debt.

What could RBI do?

- **Direct mode** - The RBI can take on the debt directly from government at an agreed rate.
- It took India long to move away from the automatic monetisation of debt. It happened in the early 1990s.
- Even if the RBI wants to support the borrowing programmes, it should not do so directly.
- **Indirect mode** - The indirect method, which is not new, is preferable as the market still sends out the signals on interest rate.
- The question ultimately relates to the extent of debt monetisation that may be undertaken.
- The country has also to guard against high inflation.

What could be done?

- The economic situation warrants enhanced government expenditure.
- The fiscal deficit will go well beyond the mandated level. This has to be accepted.
- The best course of action would be to keep the **combined fiscal deficit** at around 14% of GDP in the current year and find ways to finance it.
- This will have to be brought down gradually.
- It may take several years of normalisation.

1.3 State Governments' Finances

Why in news?

The Reserve Bank of India has studied the state governments' finances.

Where are the GFDs of states headed?

- Due to the Covvid-19 pandemic, the gross fiscal deficits (GFDs) of state governments may **double in 2020-21**.
- In 2020-21, about half of the states have budgeted the GFD to gross state domestic product (GSDP) ratio at or above the 3% threshold.
- But most of these budgets were presented prior to the onset of Covid-19.
- The direction of possible revision is evident from the fact that,
    1. The average for states presenting their budget before the outbreak of the pandemic is 2.4%.

2. But the average for the balance number of states that made post-outbreak budget presentation is 4.6% of GSDP.

- Thus, states are grappling with the pandemic with **constrained fiscal space**.
- In terms of primary balances, states are in an unfavourable position.

Will the stress on states continue?

- The crisis literature focuses on the operation of the scissor effects: **revenue loss** due to demand slowdown, coupled with **higher expenditure** associated with the pandemic.
- The duration of stress on state finances will be contingent upon factors like tenure of lockdown and risks of renewed waves of infections.
- All of this makes traditional backward-looking tax buoyancy forecasting models unreliable, according to the RBI study on state finances.
- The quality of spending and the credibility of the state budgets will assume critical importance.
- The next few years are going to be challenging for the states.

What will be the impact on states?

- As tax revenues fall faster than GDP when growth is negative, **tax revenues** may be **reduced** for the next few years.
- Pandemic related spending, particularly on health and other support measures for households and firms may keep these expenditures high.
- This may prolong the ‘scissor effect’.
- In addition, states’ fiscal position is to be affected by a **surge in contingent liabilities** (guarantees).
- In this environment, state governments may have to face the difficult choice of putting investment projects on hold.
- But, given the multiplier associated with capital spending, this will inevitably entail growth losses in a vicious circle feeding itself.
- If the rising States’ indebtedness is not accompanied by acceleration in growth, fiscal sustainability will become the casualty.

What happened during earlier pandemics?

- An event study analysis was done using four pandemic outbreaks in India: 1896 plague, 1918 Spanish flu, 1957 Asian flu and 1974 smallpox.
- This study shows that all episodes were associated with a contraction in GDP, with the 1918 flu registering the sharpest downturn of about 13%.
- Interestingly, the recovery pattern is quite similar.
- There was a **sharp rebound** in the immediate subsequent year because of favourable base effects.
- This was followed by **contraction again**, with the GDP growth rate finally subsiding back to pre-pandemic years in about 3-4 years.
- These severe disease outbreaks have also depressed per capita economic output in the economy, albeit with varied magnitudes.
- However, the **recovery** observed was swift and complete within two years of the outbreak.

What the RBI says about the Kerala model?

- The presence of empowered local governance institutions and community participation helped Kerala in effectively reaching out to affected people.

- With the resurgence in new cases, Kerala is actively roping in the services of local self-governments (LSGs) in its fight against the pandemic.
- LSGs have emerged as frontline institutions in containing the disease and in alleviating the distress caused to the vulnerable.
- The state managed to contain the spread of the pandemic in the first wave of infections.
- However, it witnessed a second wave of infections with the arrival of non-resident Keralites and with the easing of restrictions.

What does the RBI say about the Dharavi model?

- Public-private partnership and community participation played a crucial role in combating Covid-19 in Dharavi, Asia's largest slum.
- The government tied up with doctors, hospitals, NGOs, private volunteers and elected representatives and civil society organisations.
- A rapid action plan of testing, screening, early detection, contact tracing, timely isolation and putting high-risk contacts in institutional quarantine facilities was followed.
- Community participation, community kitchens and collective solidarity were the key features that helped to contain the spread of the virus.
- Enforcing a strict lockdown and blocking the movement of residents except for essential services controlled the contagion.
- Dharavi has flattened the curve and is worthy of emulation worldwide.

2. PUBLIC FINANCE

2.1 CAG Report

Why in news?

The latest audit of the Union Government's accounts reveals that the Finance Ministry retained over 40% of all cess collections in 2018-19.

How much was retained?

- The Finance Ministry retained the cess collections in the Consolidated Fund of India (CFI).
- As many as 35 different cesses, levies and charges yielded ₹ 2.75-lakh crore in the year.
- But only ₹ 1.64-lakh crore was remitted to the specific reserve funds for which these cesses were levied.

What does this reveal?

- This helped understate India's revenue and fiscal deficit numbers.
- It also helped to understand that the purposes for which Parliament approved such cesses were not met.

Is the urge for a corrective action new?

- The Comptroller and Auditor General (CAG) of India has urged the Finance Ministry to take immediate corrective action.
- This is not the first time.
- Over 10 years, the ₹ 1.25-lakh crore of cess collected on crude oil was transferred to an oil industry development body it was meant to finance.
- Part of the hefty cess collected as additional excise duties on petrol and diesel, ostensibly to finance roads and infrastructure, was retained.

What were the other cesses retained?

- A new 4% Health and Education Cess on income tax was partly deployed towards education, but no fund was created for health.
- Ditto with a Social Welfare surcharge levied on customs.
- None of these lapses can be considered unintentional.

What is the issue with the GST Cess?

- The GST Compensation Cess, over which the Centre and several States have now locked horns, was not spared either.
- Around ₹ 47,272 crore was not remitted to its rightful account over the first two years of GST.
- The compensation cess transfers to States were accounted as Grants-in-aid to States, distorting the Centre-States fiscal math.

What should the Centre do?

- As per the 14th Finance Commission's suggestions, the States' share of the divisible pool of taxes was raised to 42%.
- After this, the Centre's reliance on cesses and surcharges to raise revenue has increased significantly.
- Cess receipts are not part of this 42% pool.
- Though it is arguable whether such levies are in sync with a nation trying to simplify its tax regime, their intended use to fund specific public spending needs serves as an acceptable rationale.
- With a climate of distrust hovering over India's federal polity, it is critical for the Centre to **rebuild bridges**.

What is needed?

- Cesses, starting with the excise duties on petrol and diesel, need to be **rationalised**.
- Absolute **transparency** is needed in the management of cess receipts so that Parliament and the people do not wait for audit findings to learn of this subterfuge.

2.2 GST Council Meet

Why in news?

The GST Council's recent meeting was able to make slight progress.

In what aspects progress was seen?

- The progress is made in two respects, which includes Simplifying the return filing process and Taking a tentative step forward in resolving the impasse over compensation cess.

What are the options?

- **Option 1** - The Centre raised the compensation payable to the States under 'option one' from ₹ 97,000 crore to ₹ 1,10,000 crore.
- Under this option, the States can borrow through a special window of the Reserve Bank of India.
- The entire principal and interest on the borrowing would be borne out of the cess.
- **Option 2** - This option involves the States borrowing the entire shortfall of ₹ 2,35,000 crore from the market.
- The interest will be borne by the States.
- **Opting** - While 21 States have opted for the first option, the remaining (largely Opposition-ruled) have opposed the terms.
- The latter States are demanding the 14% annual increase in GST revenues to States that was written into law.

What did the Centre say?

- The Centre has promised that all the dues of the States will be settled through the extension of the compensation cess beyond June 2022.
- It has released ₹ 20,000 crore of compensation cess collected this year.
- The opposing States should not insist on an escalation to the dispute redress mechanism.
- This would delay and complicate the process for all States at a time when their need for funds is immediate.

What is the move regarding return filing system?

- The intent to move towards auto-populated returns and invoice matching could check tax evasion and improve revenue collection.
- From January 2021, taxpayers would have to provide details required in the GSTR 1 return alone, regarding outward supplies.
- Other data pertaining to input tax credit will be captured from the suppliers and the net tax payable will be shown in the GSTR-3B return.
- These measures show that the GST return filing system is moving back to its original design of ease of compliance and improved collection.
- This move should be viewed along with requirement for businesses with turnover exceeding ₹ 500 crore to file e-invoices from October, 2020.

What is another good move?

- Almost 93% of the 1.3 crore GST registered taxpayers are smaller businesses having less than ₹ 5 crore of annual turnover.
- Providing leeway to these smaller businesses to file returns on a quarterly basis from next year is a good move.
- This move will provide relief to the majority of the businesses, cutting down their compliance costs to a third.
- However, there could be glitches for a few quarters.
- With small taxpayers filing quarterly returns, input tax credit could get blocked for larger taxpayers (who file on a monthly basis).
- Yet, the step may lead to larger companies persuading their suppliers to be more compliant in filing returns.
- These recent changes might further the shift of entities from the unorganised to organised sector, so far stalled by loose implementation.

2.3 Gender Budgeting

What is the issue?

- Gender Budgeting is needed to incorporate gender commitments into fiscal commitments.
- There are multiple challenges for doing gender budgeting in India, which needs to be addressed soon.

What is gender budgeting?

- It is an approach that uses fiscal policy to promote gender equality by trying to translate gender commitments into fiscal commitments.
- This is done through different processes, resources and institutional mechanisms.
- In a multi-level governance structure, the political economy of gender budgeting encompasses both the fiscal and legal frameworks.
- The interface between intergovernmental fiscal transfers and the institutions of multi-level governance also matters.

What is the legal framework in India?

- In India, gender budgeting is not mandatory by law at any level of the federation.
- The legal frameworks for gender budgeting can differ in unitary or federal states with multi-level governance.
- The frameworks for gender budgeting in India are confined only to fiscal fiat, inclusive of taxation and public expenditure policies.
- To a limited extent, it is regarding the intergovernmental fiscal transfers.
- There is heterogeneity of stakeholders, from various stages of budget formulation to implementation at multiple levels of governance.

What is the importance?

- One important aspect of gender budgeting is that it can **eliminate the statistical invisibility** of the 'unpaid' care economy.
- The invisibility of unpaid care is a significant issue.
- This was recognised as an issue by the United Nations Statistical Division (UNSD) through Systems of National Accounts (SNA) 1993.
- Properly measuring the care economy requires investment in improving measurement through, for instance, '**time-use surveys**.
- Time-use surveys are conducted in India only in six states, though it is likely to be extended to all states.

When was gender budgeting introduced in India?

- Gender budgeting was pioneered in India in the research of NIPFP in 2000-2001 with UN Women and the Ministry of Women and Child Development.
- Starting in 2005-06, a "Statement of Gender Budgeting" was introduced in the budget documents by the Union government.
- Today, the process of gender budgeting within the Union Finance Ministry starts with the 'budget circular'.
- This circular state that each ministry and department is required to undertake gender-based analysis of demand for grants within the analytical matrices.
- These matrices have been prepared by NIPFP for gender budgeting.
- Now, urgent policy reform is required to revive the gender budgeting secretariat.

What is the deviation?

- Underestimation or overestimation of the budget is important in driving home the accountability of the government.
- Higher Budget Estimates do not ensure higher spending.
- There is significant deviation between Budget Estimates and Revised Estimates and Actuals in India.
- The errors are high for different expenditure components of gender budgeting.
- Linking gender budgeting to outcomes involves 'public expenditure benefit incidence' analysis across income quintiles.
- It also involves the integration of gender budgets in outcome budgets.
- In India, the mechanism of intergovernmental fiscal transfers plays a major role in providing states sufficient financial resources to carry out their expenditure assignments.

What is the formula?

- A 2016 Levy Economics Institute paper devised a formula for tax devolution into which gender sensitivity could be incorporated for India.
- It has suggested incorporating the child sex ratio (0-6 years) as a gender criterion in the fiscal transfers.
- The results revealed that 'engendering' intergovernmental fiscal transfers improve progressivity.

What does the Finance Commission's report reveal?

- The 15th Finance Commission of India has submitted its **interim report** in November 2019.
- The report has integrated the criteria '**Total Fertility Rate**' (reciprocal) with 12.5% as a proxy for demographic performance of states.
- It also states that better performance in reduction of TFR serves as an indicator for better outcomes in health as well as education.
- Hence, this criterion also rewards States with better outcomes in those important sectors of human capital.
- The 15th Financial Commission's **final report** is due in October 2020.
- One has to wait and see whether they design a conditional grant for strengthening gender budgeting at the state level.
- Designing a conditional transfer (specific purpose grant) to strengthen gender budgeting can be directly linked to gender equality outcomes.

What is needed?

- Incorporating a gender criterion in the tax-transfer formula is an ideal solution for 'engendering' intergovernmental fiscal transfers.
- However, the effectiveness of such unconditional fiscal transfers on gender equality outcome depends on how a State prioritises and designs gender budgeting programmes for gender equality.

2.4 Boosting Demand

Why in news?

The Centre has come up with an innovative option to spur consumption in the economy without any fiscal impact.

What are the moves made?

- **Allowances** - The 45 lakh or so Central government employees have been offered an interesting scheme.
- If they spend, on GST goods, up to thrice of their leave travel assistance and their leave encashment amount, 45% of that spending will be borne by the Centre.
- The Centre would have paid those allowances to its employees anyway; hence, the net fiscal outgo is negligible.
- **Festival advance** - The Centre's festival advance of ₹ 10,000 is repayable over ten months; for now, they will boost the economy.
- These moves are made to propel the economy into positive territory in quick time.

What is the Centre trying to do?

- The Centre appears to be infusing some sort of a 'Pay Commission effect' into the economy.
- It is notable that the Sixth Pay Commission award coincided with the 2008 financial crisis, and worked as a significant demand stabiliser.

What is the problem?

- For an economy that registered a 20% real fall in Q1 in private consumption, this scheme can make a difference if government employees bite the bait.

- The question, of course, is whether they will.
- Given the tax breaks built into the offer, the scheme is not unattractive.
- But the issue is that people are still worried about their finances in the context of the pandemic and its impact on the economy.
- So, will they boldly spend such large sums on non-essential items is the question that needs an answer.
- This amount can be spent on consumer durables, furniture, renovation of homes and two-wheelers, if not low-end cars.
- All these sectors can generate significant employment, provided they are GST registered entities.

Will the festival allowance have an impact?

- The festival allowance is likely to spur general spending.
- The Centre has assumed a promising multiplier by mentioning a demand creation of ₹ 28,000 crore.
- This includes ₹ 9,000 crore that the States will most probably fork out for their employees.
- As for the States' coffers, the higher demand is expected to push up GST collections to their benefit as well.

Why this move is welcomed?

- The Centre has rightly extended its 'stimulus' to the capital expenditure (capex) side.
- It has pushed an additional expenditure of ₹ 25,000 crore, in addition to the outlay of over ₹ 4 lakh crore for this fiscal.
- However, its ₹ 12,000 crore interest-free loan to the States is rather modest given their dire financials.
- Also, given the delayed impact of capex on output, the demand effect would be less than ₹ 73,000 crore set out by the Centre.
- Nevertheless, the package is innovative and significant.

2.5 Real-time tax dispute resolution

Why in news?

Recently Finance Minister told CII audience that real-time mechanism are expected to be created to ensure tax differences don't become tax disputes.

What is the problem with existing mechanism?

- In the last five years, disputed direct tax claims have risen 2 times (from Rs 4.1 lakh crore in FY14 to Rs 8 lakh crore in FY19) while actual direct tax collections have risen 1.8 times (from Rs 6.3 lakh crore to Rs 11.4 lakh crore).
- The taxman is losing lots of cases in the tribunals and courts & a large share of the disputed tax claims are probably not genuine.
- Moreover, these disputed tax amounts are growing every year.

Why taxman appeals in most disputed cases even after losing it?

- They fear that the CAG & CBI will allege them for favouritism & investigate them.
- The government has to ensure that mediation panel has enough legal protection to do their job.
- Despite amending the **Prevention of Corruption Act** several times, it is unclear that the protection is absolute to them & it is unlikely tax officials manning the panel or even the independent experts in it would be willing to take a risk.

How this can be addressed?

- There needs to be some penalty against taxmen who make arbitrary demands.
- The tax Board needs to examine tax demands—where the tax implications are large—and to scrap them if they appear unreasonable and must issue necessary clarifications to field officials.
- Its high time that government should take a call aftermath the global arbitration panel awarded ruling in favour of Vodafone Plc.

3. INFLATION

3.1 Monetary Policy Review

Why in news?

The Reserve Bank of India (RBI) has reviewed its monetary policy lately.

What does the review indicate?

- This review indicates that the RBI will prioritise the revival of economic growth over inflation through the end of the current financial year.
- The RBI has reconstituted the Monetary Policy Committee (MPC), with three new external members.
- The MPC unanimously voted to keep policy interest rates unchanged.
- This was said even as it categorically stated that the RBI would continue with the accommodative stance to revive growth on a durable basis and mitigate the impact of Covid-19 on the economy.

What did the RBI find?

- The MPC tilted away from its inflation targeting mandate by downplaying the risks on the price pressures front.
- This is because the RBI has found that **supply shocks** were responsible for keeping inflation above the tolerance band for months.
- These shocks should dissipate as the economy unlocks, supply chains are restored, and activity normalises.
- As part of the shift in priority, it projected that it would stick with the accommodative stance during the current and the next financial year.
- This forward looking guidance prompted one of the new members to dissent and vote against the wording.
- The MPC's majority view of ensuring a 'dovish' position on interest rates for at least six months has left it little near-term leeway to tame price pressures.

What did the RBI Governor emphasise on?

- The RBI Governor emphasised that the current 'inflation hump' was a brief phenomenon that needs to be looked through when taking measures to help the economy return to its feet.
- The RBI has taken a series of liquidity enhancing and credit flow supportive steps.
- With these steps, the RBI reiterated its commitment to maintain stability in the financial markets.
- This comes at a time when the resources-strapped Central and State governments are expected to resort to substantially higher levels of borrowing to meet their spending needs.
- There can be no argument that the economy needs all the support it can get to recover from its 23.9% estimated contraction of the first quarter.

What is the forecast?

- The RBI sees a gradual recovery.
- It has forecasted a marginal growth of 0.5% in the fourth quarter that would narrow the full-year contraction to 9.5%.
- It is the inflation assumptions, however, that cause disquiet.
- From a projection of 6.8% for Q2, CPI inflation is posited to sharply ease: 5.4% in Q3 and 4.5% in Q4.
- There are risks like persistence of supply bottlenecks, cost-push pressures from higher taxes on transport fuels and the possibility of food-price inflation.
- In overlooking these risks that becoming entrenched pose to the outlook on prices, the RBI has clearly sought to talk up confidence.

4. BANKING

4.1 KV Kamath Committee

Why in news?

The KV Kamath committee was set up by the Reserve Bank of India (RBI).

What is the purpose of the committee?

- The committee was set up to look into the **restructuring needs** of large borrowers hit by Covid.
- The panel was set up to deal with accounts where the aggregate exposure of the lending institutions at the time of invocation of the resolution process is ₹ 1,500 crore and above.

What are the findings?

- The committee has identified 26 vulnerable sectors and, the specific financial frailties of each.
- The sectors identified cover much of the manufacturing and infrastructure universe, besides retail outlets, hotels and tourism.

What did the panel say?

- The panel spelt out sector-wise thresholds with respect to EBITDA, debt service coverage, current assets and liabilities, total outside liability vis-a-vis adjusted tangible net worth.
- It has spelt out clear **restructuring guidelines** for banks to ensure that errors with respect to corporate debt restructuring don't recur.
- Restructuring has seen many avatars over the last decade, be it 5/25 (scheme for infrastructure assets) and S4A, which did not succeed.
- The specific crisis arising out of Covid necessitated a response for large players.
- This supplements the earlier efforts to boost the MSME sector as well as units where the aggregate exposure exceeded ₹ 100 crore.

How will these proposals be implemented?

- Banks will present their board-approved **resolution policies** taking into account the RBI final guidelines.
- Broad guidelines will also be put in place for restructuring of retail loans.
- The RBI has allowed banks to recast loans which were classified as standard as on March 1, 2020.
- For implementing resolution plans, signing of inter-creditor agreement (ICA) is mandatory in all cases involving multiple lending institutions.

- The resolution framework will be invoked before December 31, 2020.
- It will be implemented before 180 days from the date of invocation.
- The process has to be approved by lenders with 75% in value and 60% in numbers.
- Lenders signing ICA will have to make a 10% provision and non-signing lenders at 20%.
- Any default by the borrower with any of the lenders that signed an ICA during the monitoring period would trigger a review period of 30 days.
- If the borrower remains in default at the end of the period, all lenders would downgrade the account as a non-performing asset (NPA).

What are the reliefs?

- MSMEs have received liquidity and solvency packages since September 2019.
- The June 2019 RBI circular addresses the 'resolution plan' modalities for units whose aggregate exposure is above ₹ 100 crore.
- Relief to the large units will ensure flow of working capital across the supply chain, spurring industrial recovery.
- A relaxed timetable on loan repayments will aid this process.

Will the loan recast lift the economy?

- The RBI has put into place several guardrails in the form of defined timelines and external vetting.
- But, the success of the plan will largely depend upon a significant revival in the economy.
- The GDP is likely to continue contracting in the ongoing quarter.
- Based on an account level analysis, nearly 53% of this pool is at a high probability of restructuring/slippages.
- The balance 47% is at moderate risk of restructuring, and progress on these accounts will depend on the progress of Covid-19 situation.
- The biggest impact will be that banks will be able to check the rise in NPAs to a great extent.
- However, it's not going to bring down the NPAs from present levels as legacy bad loans of close to Rs 9 lakh crore will remain the same.

How were earlier schemes misused by banks and corporates?

- The RBI discontinued the corporate debt restructuring (CDR) scheme from April 1, 2015.
- For years, promoters of many big corporates were siphoning off bank funds while their units suffered.
- They approached CDR cells of banks to get their loans recast, some of them managing this more than once.
- Some of those who misused CDR are now in the bankruptcy court.
- The RBI later introduced three more loan recast schemes which either remained largely on paper or were abused by borrowers.
- The Insolvency and Bankruptcy Code finally kicked off and the RBI announced a stringent loan resolution process.

What could be done?

- The RBI should focus on higher provisioning, and in a graded manner, for restructured loans.
- This should allow banks to take some initiative on the lending side.
- An ongoing committee that can provide expertise to banks from time to time on loan restructuring can also be considered.

- Over time, a centrally conceived template for lending and restructuring will enhance credit appraisal skills along the rank and file of the banking system.
- That said, the need for such a framework cannot be overstated in these times of crisis.
- It seeks to reconcile prudence with higher lending.
- It is for the banking sector to pick up the tab.

4.2 RBI and Data Technology

Why in news?

The Reserve Bank of India (RBI) plans to use big data to track and identity tax defaulters.

What did the RBI suggest?

- The RBI's Annual Report 2020 suggests to use big data analytics to,
    1. Track and identify tax defaulters,
    2. Increase the taxpayer base by tracking their income and wealth parameters.
- It is not very clear from the report whether the RBI wants to do the tracking by itself or expects the Centre to take the reins.

What is the concern?

- This suggestion is a cause for concern considering the privacy and rights risks involved in such a proposal.
- The report claims the move is aimed towards boosting fiscal revenues.
- But global experiences, especially from China where such tracking systems already exist in various forms, suggest that,
    1. Such moves have the potential to be misused and
    2. Such moves can cause serious damage to individuals' privacy.

What does the Data Science Lab use?

- The RBI's Data Science Lab is using advanced technologies to improve data quality, surveillance and early warning detection abilities.
- The lab also employs big data analytics to provide inputs for policy formulation and monitoring.

How should such technologies be applied?

- The application of such technologies must remain at a macro level.
- Extreme caution must be applied while using tracking technologies at the micro level.
- The Centre has been toying with micro-level monetary surveillance through initiatives like the Income Tax department's 'Project Insight'.
- 'Project Insight' uses algorithmic tools to track individuals' spending patterns through their social media posts and match them with their declared income to find anomalies.

What are the benefits of using these techs?

- Tracking technologies powered by big data analytics offer great temptation to authorities across the globe.
- This temptation is because of their potential to transform the surveillance landscape in unimaginable ways.
- Granted, they make regulation a lot easier.
- But governments and agencies such as central banks must know where the line of control begins and where it ends.

How should a move be?

- Any move to track individual spending through social media must adhere to global best practices such as the EU's General Data Protection Regulation. This move must respect the consent of the individuals involved.
- Globally, a heated debate is raging over the racial, gender and class biases of algorithmic tools used to track and filter various candidates.
- Hence, it is best advised that such moves should be left open for a public debate before they are made into the law.

4.3 Revised Long Format Audit Report

Why in news?

The Reserve Bank of India (RBI) has asked banks to implement the revised Long Format Audit Report (LFAR) from 2020-21.

What is the current version?

- The current version of the LFAR was devised way back in 2002.
- It should be submitted by the bank auditors to the bank management and the RBI.
- Those were relatively innocent times, with banking transactions and record keeping done manually to a large extent.
- Risk management was not as big a focus area as it is now.
- But, over the past two decades, banking has undergone a sea-change with digital banking, core banking systems and risk management.

What the revised LFAR has sought to do?

- The revised LFAR has sought to keep up with the times and address the requirements of technology-driven banking systems.
- It has done away with some questions that are no longer relevant.
- The revision also seems to have been accelerated by the seemingly unending crises in the banking system over the past few years.
- The revised LFAR has increased focus on a spectrum of risk management at banks, specific queries on credit assessment, information systems, compliance with regulations, etc.
- It wants the auditors to comment on adverse features considered significant in the top 50 standard large advances and which need the management's attention.
- Queries on capital adequacy, resolution of stressed accounts, initiation of IBC process, KYC, anti-money laundering, countering of financing of terrorism and cyber security are welcome.
- Also, there is more coverage of potential fraud areas.

What is the significance?

- A specific time-window of 60 days to submit the LFAR to the RBI should pave the way for more seriousness about the report.
- There is a focus on red-flagged accounts and early warning signals.
- This, along with other provisions, should translate into robust LFARs by both statutory central auditors and branch auditors.
- It should help identify frauds and NPAs in a timely manner.

What are the problems?

- The revised LFAR could mean longer processes and increased responsibilities for auditors. There could be limitations on conducting 'going concern' assessments, especially in these Covid-troubled times.
- Besides, the ongoing problem of limited time to branch auditors could continue to pose challenges to the effectiveness of the LFAR.

What could be done?

- The questions on areas such as new-age banking security could have been more focussed.
- For the revised LFAR to work, all stakeholders including the RBI's nominees on bank boards must play their part effectively.

4.4 SBI's Loan Recast Scheme

Why in news?

Banks led by State Bank of India are offering a moratorium of two years to retail investors.

What are the reliefs?

- The relaxations under the framework, subject to compliance of bank norms, include
    1. Moratorium of up to a maximum of 24 months,
    2. Rescheduling of instalments, and
    3. Extension of tenure by a period equivalent to the moratorium granted subject to a maximum of 2 years.
- During moratorium, borrowers don't have to pay EMIs on the loan.
- Interest will be applied during the moratorium period.
- The moratorium sanctioned under the framework will be in addition to the moratorium granted by the bank earlier.
- If the borrowers have surplus cash during the moratorium, they can pay EMIs during the moratorium.
- This will help in reducing the interest amount.

Will there be any change in EMI after the loan recast?

- The tenure of the loan will be extended by the period of the moratorium i.e 24 months.
- The EMI payable after the moratorium will be recalculated and advised to the customers.

Will there be any change in pricing of the loan?

- Interest will be applied during the two-year period.
- Borrowers should pay additional interest of 0.35% per annum over and above their current pricing for the remaining tenure.
- This is to offset the partial cost of additional provisions required to be made by the bank.

Who is eligible for loan restructuring?

- The main criterion is whether the borrower is impacted by the Covid-19 pandemic.
- A retail borrower will be considered as affected by the Covid-19 pandemic if they fulfil certain conditions laid down by the SBI.
- To be eligible under the recast framework, the following eligibility conditions need to be fulfilled:

1. The retail loan should be a “standard account” as on the date of application for relief under this framework; and
2. It should have been “standard” and not in default for more than 30 days as on March 1, 2020.

- The beneficiaries include those who have taken home, education, auto or personal loans under the loan restructuring policy approved by the Reserve Bank of India (RBI).

What is the maximum age up to which the tenure can be extended?

- The SBI says this is product specific.
- In the case of home loan, the tenure of the loan can be extended up to a maximum of 24 months or till the primary borrower attains 77 years of age, whichever is earlier.
- In any case, the tenure can be extended only up to maximum 24 months under this framework for Covid-19 related stress.
- The last date to apply for relief under the framework is December 24, 2020.

Is a borrower eligible for restructuring of multiple loan accounts?

- A person can apply for relief under the framework in more than one account.
- If one of his loan accounts is irregular for more than 30 days as on March 1, 2020, other standard accounts which met the eligibility criteria would be eligible for relief.
- However, the customer’s eligibility for a new loan will depend on the prescribed eligibility norms for the respective loan scheme of the bank.

How does retail recast compare with corporate loan recast?

- The retail loan restructuring is on liberal terms when compared to the corporate loan recast plan recommended by the Kamath Committee.
- The RBI has broadly accepted the Committee’s recommendation to take into account five specific financial ratios.
- It has also accepted the sector-specific thresholds for each ratio in respect of 26 sectors while finalising the resolution plans.
- The process is complicated as signing of Inter-Creditor Agreement (ICA) is a mandatory for all lending institutions in all cases involving multiple lending institutions, where the resolution process is invoked.

4.5 Loan Cash Back Scheme

Why in news?

The Centre waives the compound interest on loans up to Rs 2 crore.

What is the government’s proposal?

- The Finance Ministry issued certain guidelines to the banks.
- It said that the difference between the compound interest and simple interest for a period of six months will be provided to all borrowers with loans up to Rs 2 crore.

What does this mean?

- This means that the borrowers need to pay only simple interest.
- The government will pay back the difference between compound interest charged during those six months and simple interest.
- The ex gratia payment will be admissible irrespective of whether the borrower had availed the moratorium on repayment or not.

- It is for those loan accounts which are standard and not non-performing assets (NPAs) as on February 29, 2020.
- For loan accounts which were closed during this period, the ex gratia payment will be made from March 1, 2020 till the date of closure of such account.

Who is eligible for the scheme?

- The compound interest waiver is for most of the loans: housing, MSME, education, credit card dues, automobile, personal loans to professionals.
- Any borrower whose aggregate of all facilities with lending institutions is more than Rs 2 crore will not be eligible for the waiver.
- The waiver will be provided by all private and state-owned banks, cooperative banks, regional rural banks, housing finance companies and non-banking financial institutions.
- The rate of interest used to calculate the ex gratia amount will be based on the contracted rate specified for most loans.
- Exact waiver benefit will depend on the stage of the loan and outstanding principal amount.

What is the relief being offered to borrowers?

- This waiver may come as a relief to borrowers, mainly whose loans are in initial years of repayment as their interest component is a major chunk.
- This would help in reducing the burden on borrowers as they are required to pay the contracted rate of interest on loans.
- However, customers will still have to bear the liability of simple interest accumulated during the six of the moratorium period.

How's the calculation done?

- The government has specified that for reimbursement, the compounding of interest should be reckoned on a **monthly basis**.
- The rate of interest to be applied for calculating the difference will be the contracted rate as specified in the loan agreement.
- For credit card dues, the rate of interest will be the weighted average of lending rate charged by the card issuer for transactions financed on the EMI basis during the period from March 1, 2020 to August 31, 2020.

Will the bank be able to handle it?

- Bankers say that it's not an easy task and involves more paperwork for banks and housing finance firms.
- Banks should process the claims of borrowers and credit the amount.
- They will have to lodge the claim for reimbursement with the designated cell at State Bank of India (SBI) by December 15, 2020.
- SBI, nodal agency for the scheme, will evaluate the claims and furnish the details to the government.
- Lending institutions will get the funds through SBI.

What's the cost to the government?

- The cash outgo from the government is likely to be between Rs 5,000-7,000 crore as all the borrowers may not be eligible for the scheme.
- However, the government has not given any deadline on paying up the cash-back to the banks.

4.6 Interest Waiver

Why in news?

The Supreme Court (SC) has directed the government to implement the waiver of "interest on interest" for borrowers with an exposure of up to Rs 2 crore.

What does the SC decision mean?

- The SC wants the government to waive it by November 2, 2020.
- The hearings will continue and a final verdict is some time away.
- The SC seems to be comfortable with the idea of the government picking up the tab for the loss banks would incur by not charging the compound interest on exposures that were allowed a moratorium.
- The decision would come as a huge relief for both banks and the Reserve Bank of India (RBI).

Who would be eligible for waiver?

- The SC is not going to recommend a waiver of compound interest for bigger exposures—of more than Rs 2 crore.
- In other words, the government will reimburse banks for compound interest due only from smaller borrowers.

Is it a good practice?

- Waiving interest on loans can never be a good practice since it creates a moral hazard and vitiates the borrowing environment.
- Given the unprecedented pain caused by the pandemic, the SC's view is understandable.

What is important?

- It is important that the SC has allowed the government to pay the bill, sparing the banks.
- Also, the waiver is restricted to just the smaller borrowers.

What did the government say?

- In its affidavit to the court, the government had pointed out that waiving the interest on all loans and advances, across all categories of borrowers, for a period of six months would cost Rs 6 lakh crore.
- Clearly, banks are not financially strong enough to bear this burden.
- It would wipe out a substantial part of their net worth and make many of them unviable.
- As the government observed, lending institutions need to survive the current crisis, and promises made to depositors need to be honoured.
- If customers are to be paid interest on their deposits, borrowers need to pay interest on the loans.

What could be done?

- **Sub-limits** - Not all categories of borrowers are equal.
- It would only be fair if the government specifies different sub-limits for each segment of borrowers because taxpayers should not be subsidising those who can afford to pay the interest.
- **Declaring NPAs** - The RBI has been concerned, with the SC directive regarding non-performing assets (NPAs).
- The SC had directed the banks not to classify any loans as NPAs if they had not been declared as such on August 31.
- Hopefully, banks will soon be permitted to classify loans as per the rules because it is important that they provide for them immediately.

- **Setting aside capital** - Given how a big chunk of loans is expected to go bad, it is important banks set aside enough capital for these losses.

4.7 Moratorium on Lakshmi Vilas Bank

Why in news?

RBI imposed a 30-day moratorium (temporary suspension of activities) on Lakshmi Vilas Bank Ltd (LVB) & proposed a draft scheme for its amalgamation with DBS Bank India.

Why was LVB put under moratorium?

- The financial position was declining steadily, with continuous losses over the last three years eroding the bank's net-worth.
- Its gross non-performing assets (NPAs) stood 25.4% of its advances as of June 2020, as against 17.3% a year ago.
- It was also experiencing continuous withdrawal of deposits and low levels of liquidity.
- There were serious governance issues which have led to deterioration in its performance.
- The bank management had indicated to the RBI that it was in talks with certain investors, but failed to submit any concrete proposal.
- So it was merged with DBS Bank.
- Also, the RBI has put a cap of Rs 25,000 on withdrawals & assured depositors of the bank that their interest will be protected.

Are the depositors safe?

- Deposit Insurance and Credit Guarantee Corporation (DICGC) gives insurance cover on up to Rs 5 lakh deposits in banks.
- Merger Proposal will make the bank's CRAR at 12.51% and Common Equity Tier-1 capital at 9.61%.
- The RBI and the government have often assured that the financial system is safe and sound, but a series of failures might affect the confidence of depositors.

What happens to investors?

- The stock price in Yes Bank reduced below Rs 10 per share from a peak of Rs 400 per share.
- Nearly Rs 9,000 crore worth of Additional Tier-1 bonds (AT-1) were fully written off.
- In LVB, equity capital is being fully written off & existing shareholders face a total loss on their investments.

What are the issues faced by old-generation private banks?

- Most of the banks do not have strong **promoters** leading to mergers or forced amalgamation.
- South Indian Bank and Federal Bank have been operating as board-driven banks without a promoter.
- In KVB, the promoter stake is 2.11%, and in Karnataka Bank, there's no promoter.
- LVB, Yes Bank & Punjab & Maharashtra Co-operative Bank follow the similar issues.

How has the pandemic affected banking system?

- NPAs in the banking sector are expected to increase as the pandemic affects cash flows of people.
- Companies in sectors such as retail trade, wholesale trade, roads and textiles are facing stress, while NBFCs, power, steel, real estate and construction were already under stress when the pandemic began.
- The Expert committee headed by **K V Kamath** recommended a one-time loan restructuring window for corporate borrowers under stress due to the pandemic.

4.8 Banking health and the 'K Curve' dynamics

What is the issue?

- Recently, the depositors in Lakshmi Vilas Bank Limited (LVB) were bailed out.
- In this context, understanding the price performance of individual banks and focusing on the trends in valuation metrics could help in anticipating the financial system dynamics in the coming years.

What is the P/BV ratio in this regard?

- A key metric for financial companies is the 'Price to Book Value' ratio (P/BV).
- The P/BV reflects two critical attributes that the market values most:
  1. adequacy of current capital
  2. runway available to the entity for profitable growth
- **A P/BV ratio above 1** indicates that the market believes that the company can grow and generate Return on Equity (RoE) above the hurdle rate that investors expect.
- Here, the faster it can grow or the greater the spread of the ROE above the hurdle rate, the greater the P/BV multiple (above 1).
- **A P/BV below 1** indicates that the market either does not believe the bank has recognised all its bad loans or has the business model to deliver returns above the hurdle rate.
- This may be because the bank does not have a good deposit franchise, has bad cost discipline or a broken lending model.

What does a K Curve mean?

- There are banks that have a P/BV above 4 while some others have much below 1, even at 0.25.
- With NBFCs, the P/BV range is even wider, with some NBFCs being valued in excess of 7.
- The growth trajectories of these entities with dispersed P/BV will be varied, resulting in a classic K Curve.
- In other words, the K Curve **depicts the inequality** existing between different financial entities in terms of their attributes that determine their future growth and profitability.
- Widening of the arms of the 'K' would imply that the inequality is increasing.
- On the other hand, narrowing of the span of the 'K' would mean the opposite.

What is the current scenario of the banks?

- **One arm of the K:**
- Among private sector banks, a couple of banks have always had their **P/BV above 3** on a consistent basis.
  - Capital is available in plenty for these banks.
  - Resultantly, the market is betting that these banks will grow much above system average and generate attractive RoE.
  - This would imply that these banks would have disproportionate incremental market share on both assets and liabilities.
- Next comes the set of banks that have had **P/BV of above 1.5** for the most period.
  - The market insight on these banks is that they are long-term bets, and have access to sufficient capital.
  - But, these banks have to demonstrate a business model that works across cycles.
  - As comfort levels increase on the business model, the P/BV should climb, because runway for growth is available for these banks.

- Both the above set of banks **('Alpha banks')** have adequate access to capital and the intrinsic ability to grow market share.
- These banks would form one arm of the K.
    - The only constraint for these banks would be their ability to grow their liability franchise.
    - This is so because changes in market share on deposits are much slower than changes on the asset side.
- **The other arm:**
- The other private sector banks have a **P/BV of around 1 or much below 1.**
- For some of them that have demonstrated an ability to raise capital even through COVID-19 times, it is a business model issue.
    - It is also a question of whether they have strengths to grow profitably in a sustained manner.
- The new generation banks amongst these have to demonstrate consistent growth and stability on the liability side for a higher P/BV again.
- Quite a few of the old generation private sector banks have an issue with the credibility of their business model and their ability to generate above hurdle RoE through the cycle.
    - They may have a reasonably stable liability franchise.
    - But, the market perceives issues with their lending practices and thereby, asset quality.
    - That is the reason their P/BV is at very low levels.
    - They need to transform themselves by upgrading technology, add skilled manpower and improve management quality and governance.

How about the public banks?

- The current governance model of public sector unit (PSU) banks depresses valuations.
- Their P/BV would better reflect their intrinsic strengths when the banks are run in a professional manner with an ability to decide their own destiny.
- The largest bank in the country is surely part of the Alpha banks as its ability to attract capital and grow profitably is well accepted.
- The other PSU banks are viewed by the market broadly as a homogenous set with similar business models and skill sets.

What does this call for?

- Along with the government move to consolidate PSU banks into few large banks, a new vision needs to be drawn out for these banks.
- This is essential to ensure that they have differing value propositions to offer to the economy and market.
- There needs to be a clear level playing field amongst all banks.
- The government should move to paying transparent and fair compensation for services rendered to various State-sponsored programmes to all players.
- PSU banks should be free to adopt human resource practices to on-board lateral talent to fill in skill set gaps and adapt to the new digital world.
- This, coupled with better governance, is likely to result in higher P/BV for PSU banks.

What is the way forward?

- Certainly, the Alpha banks widen the gap with respect to the rest.

- This, consequently, widens the K Curve even more and squeezes out the weak banks.
- However, there is clearly more room for banks to migrate into the Alpha banks set.
    - The need now is to have more than the current handful of Alpha banks to propel it.
    - It is in all stakeholders' interest to make their own contributions to make that happen.
- [For NBFCs, the problem is complex; would both arms of the 'K' remain is the moot question for them.
- It is also to be seen if the more valued NBFCs would be the ones that become part of the Alpha banks in the long term.]

4.9 New Liquidation Regulations

Why in news?

Insolvency and Bankruptcy Board of India (IBBI) has amended the regulations for liquidation under the Insolvency and Bankruptcy Code (IBC).

What is IBBI?

- The IBBI was established in 2016 under the IBC, 2016.
- It is responsible for implementation of the IBC.
- [IBC consolidates and amends the laws relating to reorganization and insolvency resolution of corporates, partnership firms and individuals.]
- It has regulatory oversight over the insolvency professionals and professional agencies, Insolvency Professional Entities and Information Utilities.
- It writes and enforces rules for processes, like, **corporate** and **individual** insolvency resolution and bankruptcy under the Code.

What are the new regulations?

- The liquidator for a company can assign or transfer a not readily realisable asset to any person in order to ensure quick liquidation of companies which are unable to find bidders under IBC.
- The said transfer or assignment of the asset must be done in consultation with the stakeholders committee.
- The definition of "not readily realisable asset" includes any assets of the corporate debtor, which couldn't be sold through the available options.
- Any or all assets of the company under liquidation, which is facing some dispute or is involved in some fraudulent transaction, can be sold by the liquidator.

Do the changes in liquidation norms help?

- Among all, the changes to expedite the liquidation norms are likely to benefit **real estate companies** the most.
- One of the first changes to speed up the liquidation process is allowing the liquidator to assign or transfer any not readily realisable asset.
- This means that the liquidator can liquidate the entire assets of the company to different bidders as and when they come.
- The other change, which allows creditors to assign or transfer the debt to other creditors of the company, would speed up the liquidation process.

What are the likely challenges?

- The new regulations will have to be tested in a court of law as its definition of a not readily realisable asset is contentious.

- Another amended regulation that may be challenged is about the IBBI allowing the liquidator to distribute the un-disposed of assets among stakeholders, with the approval of the adjudicating authority.
- This will lead to creditors challenging the distribution of the assets, and claiming that one or the other party has been favoured by the liquidator.
- One has to wait and see how the courts decide on these issues before applying them to liquidation cases.

4.10 Conversion of NBFC's into banks

Why in news?

RBI is pushing for the conversion of large NBFC's into banks due to IL&FS and DHFL failure.

Why this Conversion is required?

- It creates uniform entities in the financial sector.
- It helps in greater regulation.
- It will lead to a higher share of the private sector in the banking (which accounts for 30 %of deposits and 36% advances).
- Even **internal working group** set up to review the ownership structure in the financial sector has suggested the relaxation of existing ownership norms for the conversion of NBFCs into banks.

Who can apply for a banking licence?

- NBFCs with an asset size of 50,000 crore and credible operating experience.
- Payments banks can convert into small finance banks provided they have a good track record of three years.
- Banks which are currently under a non-operative holding financial company structure can exit, if they don't have other group entities in their fold.
- In order to encourage new entrants, industrial houses are allowed to set up banks, provided the laws and supervision systems prevent transactions between connected entities.

Why conversion to banks is a flawed process?

- NBFCs serve the last mile which is ignored by banks and they account for a quarter of non-food credit.
- It is futile to expect NBFCs to attract low cost deposits, when the other bank regulations such as CRR and priority sector lending obligations apply.
- Despite the new tighter regulation, it is wrong to assume that NBFC's are away from the supervision.
- Even YES Bank, Lakshmi Vilas Bank failed despite laws & audit.
- Today some large business houses management are dominated by promoter family.
- The regulations should be framed such that only groups with a sound professional and transparent management with strong governance are allowed.
- On the whole, Governance is related to the RBI's supervision capacity, rather than ownership pattern or the promoters' stake.

4.11 Corporates as banks - Concerns

Why in news?

- An Internal Working Group (IWG) of the RBI constituted to "review extant ownership guidelines and corporate structure for Indian private sector banks" recently submitted its report.

- Among the recommendations, a key and controversial one is to do with allowing large corporate/industrial houses to be promoters of private banks.

Had there been similar recommendations before?

- In February 2013, the RBI had issued guidelines that permitted corporate and industrial houses to apply for a banking licence.
- Some houses applied, although a few withdrew their applications subsequently.
- No corporate was ultimately given a bank licence.
- Only two entities qualified for a licence, IDFC and Bandhan Financial Services.
- The RBI maintained that it was open to letting in corporates. However, none of the applicants had met 'fit and proper' criteria.
- RBI had also emphasized on the public concern about bank governance at that time.
- In 2014, the RBI restored the long-standing prohibition on the entry of corporate houses into banking.
- The RBI Governor then was Raghuram G. Rajan who had headed the Committee on Financial Sector Reforms (2008).
- The Committee had been against the entry of corporate houses into banking.
    - It felt back then that it would be premature to allow industrial houses to own banks.
    - This prohibition on the 'banking and commerce' combine still exists in the United States today.
    - The same is certainly necessary in India till private governance and regulatory capacity improve.
- The RBI's position on the subject has remained unchanged since 2014.

What is the rationale now?

- The Indian economy, especially the private sector, needs money (credit) to grow.
- The government-owned banks are far from being able to extend this credit.
- Even more, the government-owned banks are struggling to contain their own non-performing assets.
- Government finances were already strained before the COVID crisis.
- With growth faltering, revenues have fallen and the government has limited ability to push for growth through the public sector banks.
- Given all these, large corporates are the ones with the financial resources to fund India's future growth.
- Corporate houses can bring capital and expertise to banking.
- Moreover, not many jurisdictions worldwide bar corporate houses from banking.

What are the concerns with 'corporate-owned banks'?

- **Concentration of economic power** - Corporate houses can easily turn banks into a source of funds for their own businesses.
- In addition, they can ensure that funds are directed to their cronies, provide finance to customers and suppliers of their businesses.
- Even in private bank ownership, past regulators have preferred it to be well diversified i.e. no single owner has too much stake.
- **Risks** - RBI has always been of the view that the ideal ownership status of banks should promote a balance between efficiency, equity and financial stability.
    - A greater play of private banks comes with its own risk element. The global financial crisis of 2008 is a case in point.

- On the other hand, a predominantly government-owned banking system tends to be more financially stable given the trust in government as an institution.

- Moreover, banks owned by corporate houses will be exposed to the risks of the non-bank entities of the group.
    - If the non-bank entities get into trouble, sentiment about the bank owned by the corporate house is bound to get affected.
    - In that case, depositors may have to be rescued through the use of the public safety net.
- **Connected lending** - The main concern in allowing large corporates to open their own banks is a basic conflict of interest, or more technically, "*connected lending*".
- In simple terms, connected lending refers to a situation where the promoter of a bank is also a borrower.
- In other words, it is possible for a promoter to channel the depositors' money into their own ventures.

Why is connected lending a big challenge?

- Connected lending has been happening for a long time and the RBI has been falling short in having a check on it.
- The recent episodes in ICICI Bank, Yes Bank, DHFL etc. were all examples of connected lending.
- The so-called ever-greening of loans is often the starting point of such lending, wherein one loan after another is extended to enable the borrower to pay back the previous one.
- **Regulation** - The IWG has called for a legal framework to deal with interconnected lending.
- It also recommended having a mechanism in place to effectively supervise conglomerates that venture into banking.
- However, any legal framework and supervisory mechanism will be less adequate to deal with the risks of interconnected lending in the Indian context.
    - Corporate houses are proficient at routing funds through a network of entities in India and abroad.
    - So, tracing interconnected lending will be a challenge.
    - Also, monitoring of transactions of corporate houses will require the cooperation of various law enforcement agencies.
- **Ex-post** - The RBI can only react to interconnected lending ex-post i.e. after substantial exposure to the entities of the corporate house has happened.
- Given this, it is less likely to be able to prevent such exposure.
- Even after spotting, it is challenging to make course corrections.
- This is because any action that the RBI may take in response could cause a flight of deposits from the bank concerned and precipitate its failure.
- **Public sector banks** - Beyond the idea of growing a bank on their own, the real attraction for corporate houses will be the possibility of acquiring public sector banks (PSBs).
- Notably, the valuations of PSBs have been weakening in recent years.
- Public sector banks now need capital that the government is unable to provide.
- So, the entry of corporate houses, if it happens at all, is likely to be a prelude to privatisation.
- In that case, any sale of public sector banks to corporate houses would raise serious concerns about financial stability.

How about NBFCs conversion into banks?

- The IWG argues that corporate-owned NBFCs have been regulated for a while and thus the RBI understands them well.

- However, there is much difference between a corporate house owning an NBFC and one owning a bank.
- Bank ownership provides access to a public safety net whereas NBFC ownership does not.
- The reach and influence that bank ownership provides are vastly superior to that of an NBFC.
- In all, it is advisable in the present context to keep the class of borrowers (big companies) apart from the class of lenders (banks).

4.12 RBI's IWG Recommendations

Why in news?

An Internal Working Group (IWG) of the RBI constituted to "review extant ownership guidelines and corporate structure for Indian private sector banks" recently submitted its report.

How is the Indian banking system's performance?

- India's banking system has changed a lot since Independence.
- Back then, banks were owned by the private sector, resulting in a "large concentration of resources in the hands of a few business families".
- The government resorted to the nationalisation of banks in 1969 (14 banks) and again in 1980 (6 banks) to -
    1. achieve a wider spread of bank credit
    2. prevent its misuse
    3. direct a larger volume of credit flow to priority sectors
    4. make it an effective instrument of economic development
- But with economic liberalisation in the early 1990s, the economy's credit needs grew and private banks re-entered the picture.
- This had a notable impact on credit growth.
- However, even after three decades of rapid growth, the total balance sheet of banks in India still constitutes less than 70% of the GDP.
    - This is much less compared to global peers such as China, where this ratio is closer to 175%.
- Moreover, domestic bank credit to the private sector is just 50% of GDP.
    - In economies such as China, Japan, the US and Korea it is upwards of 150%.
- In other words, India's banking system has been struggling to meet the credit demands of a growing economy.
- There is only one Indian bank in the top 100 banks globally by size.
- Further, Indian banks are also one of the least cost-efficient.
- Clearly, India needs to strengthen its banking system to grow at a fast pace.
- In this regard, it is crucial to note that public sector banks have been steadily losing ground to private banks.
- Private Banks are not only more efficient and profitable but are also ready to take risks.
- It was against this backdrop that the RBI constituted the IWG to suggest reforms.

What was the IWG tasked to?

- Given the above, the IWG was asked to suggest changes that not only boost private sector banking but also make it safer.
- The terms of reference of the IWG inter alia included -
    1. a review of the eligibility criteria for individuals/entities to apply for banking license

2. examination of preferred corporate structure for banks and harmonisation of norms in this regard
3. review of norms for long-term shareholding in banks by the promoters and other shareholders

What are the key recommendations?

- **Promoter's cap** - The IWG has proposed to raise the cap on promoters' stake in private banks from the current 15% to 26% in 15 years.
- As regards non-promoter shareholding, a uniform cap of 15% of the paid-up voting equity share capital of the bank is prescribed for all types of shareholders.
- **Corporates as banks** - IWG has recommended that large corporate or industrial houses may be allowed as promoters of banks.
  - Large corporates refer to business houses having total assets of Rs 5,000 crore or more.
  - Here, the non-financial business of the group accounts for more than 40% in terms of total assets or gross income.
- However, this move will be rolled out only after making amendments to the Banking Regulation Act, 1949.
  - This is to deal with connected lending and exposures between the banks and other financial and non-financial group entities.
- The IWG also made a case for strengthening of the supervisory mechanism for large conglomerates, including consolidated supervision.
- **New Banks** - IWG recommended that the minimum initial capital requirement for licensing new banks should be enhanced -
  i. from Rs. 500 crore to Rs. 1,000 crore for universal banks
  ii. from Rs. 200 crore to Rs. 300 crore for small finance banks
- **NBFCs** - The panel suggested well run large NBFCs with an asset size of Rs. 50,000 crore and above, including those owned by a corporate house, may be considered for conversion into banks.
- This is however subject to completion of 10 years of operations and meeting due diligence criteria and compliance with additional conditions specified.
- **Payments Banks into SFBs** - The panel has proposed a reduction in the time-frame needed for payments banks to convert into small finance banks (SFB) to 3 years from 5 years.
- A change has also been suggested in the listing criterion for SFBs and payment banks.
- They may list -
  i. within 6 years from the date of reaching the net worth equivalent to prevalent entry capital requirement prescribed for universal banks (or)
  ii. 10 years from the date of commencement of operations, whichever is earlier
- **NOFHC** - Non-operative Financial Holding Company (NOFHC) should continue to be the preferred structure for all new licenses to be issued for universal banks.
  - [NOFHC is a category of non-banking finance company (NBFC), registered as an NBFC with the RBI.
  - It is governed by a separate set of directions issued by RBI.
  - The objective is to separate several financial activities carried out by the same holding company.]
- However, it should be mandatory only in cases where the individual promoters / promoting entities/ converting entities have other group entities.
- Banks licensed before 2013 may move to an NOFHC structure at their discretion.

- However, once the NOFHC structure attains a tax-neutral status, all banks licensed before 2013 shall move to the NOFHC structure within 5 years from announcement of tax-neutrality.

- The concerns about banks undertaking different activities through subsidiaries joint ventures (JVs)/associates should be addressed through suitable regulations till the NOFHC structure is made feasible and operational.
- Banks currently under NOFHC structure may be allowed to exit from such a structure if they do not have other group entities in their fold.
- **Licensing guidelines -** The panel called for the RBI to take steps to ensure harmonisation and uniformity in different licensing guidelines, to the extent possible.

What are the benefits of the recommendations?

- **Growth -** The RBI panel has suggested opening the field to new players.
- This may provide a wide choice to consumers in terms of products and pricing.
- By initial indications, 9 private sector and 5 state owned NBFCs may get qualified to set up, or turn into, banks adding to the present strength of 143 banks (June 2020).
- This is likely to expand the banking network that should help the economy reach its growth potential.
- **NBFCs -** The IWG's recommendation to allow conversion of large NBFCs into banks could increase the size of the banking system itself.
- With at least 10 years as shadow banks, they will have a different approach to credit appraisal; risk-based pricing, monitoring and recovery strategies.
- **NOFHC -** A non-operative finance holding company (NOFHC) structure to separate ownership and management control is expected to take care of the 'conflict of interest' issues.
- This is in line with the recommendations of the PJ Nayak Committee report reviewing 'Governance of Boards of Banks in India'.
- The committee even called for Public Sector Banks (PSBs) to separate government ownership and grant autonomy in their functioning.
- The transition of the ownership structure of existing private banks licensed before 2013 is also clearly outlined.

What are the challenges before the RBI?

- With expansion of number of banks and non-banks, the onus of the RBI to oversee the orderliness, sustainability and compliance standards will increase.
- Fintech companies, peer-to-peer lenders and neo-banks add to the challenges of the supervisory system.
- Cooperative banks and housing finance companies are already added to the list of regulated entities of the RBI.
- So, the RBI has to plan and reorient its human resources and draw in new talent to oversee the rapidly expanding banking system.
- It must especially track signs of stress and ensure that there is no systemic threat.

5. MONEY MARKET

5.1 Backstop Entity

Why in news?

The Chairman of Securities Exchange Board of India (SEBI) suggested for a backdrop entity.

What are the suggestions?

- Referring to Franklin Templeton freezing investor payouts by shuttering six open-end schemes, the SEBI's Chairman mooted three possible measures to prevent a repeat.
- He suggested a **backstop entity** that would buy out illiquid corporate bonds from debt funds during stress, with support from industry players.
- He proposed an **advisory committee** to come up with mechanisms for stress-testing and swing pricing of debt funds.
- **Interim rules** will be framed requiring all debt funds to park a minimum proportion of their assets in liquid instruments.

Is there any pushback?

- All this has attracted pushback from debt fund managers.
- They complain that creating a backstop facility will pose practical difficulties and that holding liquid instruments would dilute returns.
- But such complaints divert focus from the structural anomaly in open-end debt schemes that promise anytime liquidity to their investors, while investing mostly in illiquid corporate bonds.
- This problem is bound to crop up time and again hurting investors, unless SEBI finds lasting fixes to it.

What did AMCs do?

- In recent years, domestic Asset Management Companies (AMCs) have amassed debt assets of ₹ 12.6 lakh crore.
- They have pocketed handsome fees, from selling 'high-yield' funds that dabble in illiquid corporate bonds.

What is the problem?

- The problem of bunched-up redemptions in such funds is of industry's own making as it has actively wooed corporate treasuries and High Net worth Individuals (HNIs) to these funds.
- Now it is only fair that the industry foots the bill to ensure that these funds fulfil their promise of anytime liquidity, instead of knocking at regulators' doors every time there's a crisis.
- The RBI's latest MF liquidity window marks the third occasion on which it has had to bail out the industry after the crises of 2008 and 2013.
- This raises questions of moral hazard.

How should the appropriate size be arrived?

- The appropriate size for a backstop entity can amount to 20% of the ₹ 1.5 lakh crore assets managed by credit risk and corporate bond funds.
- Also, every AMC could contribute in proportion to the assets it manages.

What is next?

- If the industry feels that such a backstop is difficult to fund, it needs to curtail corporate debt funds managed in the open-end format.
- They should move to a more manageable close-end format.
- SEBI can allow debt funds to gate redemptions for limited periods.
- It can apply investor-level caps on fund holdings to prevent bunched-up outflows.
- Many of these issues would sort themselves out once India's corporate bond market attains a reasonable stage of development.
- For this, SEBI needs more active support from the Centre and RBI.

5.2 Multi-cap Mutual Funds

Why in news?

The Securities and Exchange Board of India (SEBI) has made a move to change the asset allocation in multi-cap mutual funds.

What is the aim of the move?

- It is aimed at making mutual funds (MFs) 'true to label' and broad-basing trading activity in the market.
- It is also aimed at improving volumes in small-cap stocks.

What is the problem?

- The **implementation** and **timing** leave much to be desired.
- It has been stipulated that the MFs should allocate 75% of the assets in equity of 25% each in large, mid and small-cap stocks as investments.
- Also, it wants the re-allocation to be done within a short timeframe.
- It is unfair to investors who have parked money in these funds based on their current investment strategy.
- Re-allocation of assets based on the new mandate would have resulted in spiking the demand for small-cap stocks, driving up their prices.
- However, the SEBI has assuaged sentiments, by showing willingness to reconsider its decision.

What SEBI could have done?

- If SEBI wanted multi-cap funds to invest according to their label, it should have laid down the sub-limits in 2017 when all other MF schemes were recategorised.
- At that time, SEBI had given ample flexibility to multi-cap schemes by not setting limits for each market cap.
- It stopped with the overall cap of 65% for equity investments.

What was the impact of this flexibility?

- Fund managers had used it to invest a bulk of the assets in large-cap stocks that appeared better placed to deliver sound returns to investors.
- Investors have also parked almost ₹ 1.5 lakh crore in these funds.
- They believed that the fund managers will allocate their money across market capitalisation, depending on the prospects of each segment.

What would the fund managers do now?

- A problem that fund managers will face is that small-cap stocks with good fundamentals and robust trading volume are limited.
- They are unlikely to be able to increase the allocation towards small-cap stocks to 25% of assets, without harming investors' interest.
- Also, the stock market is currently in a vulnerable state with high speculation driving up stock prices.
- This isn't the time to encourage trading activity in smaller stocks.

What did SEBI clarify?

- The SEBI has clarified that fund houses can allow investors to,
    1) Switch to other schemes,
    2) Merge their multi-cap scheme with their large-cap scheme or
    3) Convert their multi-cap scheme to another category.

What could SEBI do?

- The SEBI could introduce another equity fund category, **flexi-cap funds** that operate with the mandate of the present multi-cap funds.
- This would cause the least disruption to investors as it would involve only change in the fund name.
- If the SEBI intends to insist on asset re-allocation,
    1) A longer time should be given for re-balancing and
    2) The limit of 25% towards small-cap stocks should be lowered.

5.3 ESG Funds

Why in news?

ESG funds are witnessing growing interest in the Indian mutual fund industry.

What is ESG?

- ESG investing is used synonymously with sustainable investing or socially responsible investing.
- They imbibe environment, social responsibility and corporate governance in their investing process.
- While selecting a stock for investment, the ESG fund shortlists companies that score high on environment, social responsibility and corporate governance, and then looks into financial factors.
- So, the schemes focus on companies with environment-friendly practices, ethical business practices and an employee-friendly record.

Why so much focus on ESG now?

- Fund houses say modern investors are re-evaluating traditional approaches, and look at the impact their investment has on the planet.
- As a result of this paradigm change, asset managers have started incorporating ESG factors into investment practices.
- A majority of studies highlights that companies with good ESG scores tick most of the checkboxes for investing.

How big is ESG?

- There are over 3,300 ESG funds globally and the number has tripled over the last decade.
- The value of assets applying ESG to investment decisions is $40.5 trillion.
- In India, there are three schemes following the ESG investment strategy,
    1. SBI Magnum Equity ESG (Rs 2,772 crore),
    2. Axis ESG (Rs 1,755 crore) and
    3. Quantum India ESG Equity (Rs 18 cr).
- ICICI Prudential's scheme launched its NFO recently and more are expected to follow.

What change can it bring?

- As ESG funds gain momentum in India, companies will be forced to follow better governance, ethical practices, environment-friendly measures and social responsibility.
- Globally there has been a big shift as many funds don't invest in companies that are seen as polluting or don't follow social responsibility.
- In coming years, companies that do not follow sustainable business models will find it tough to raise both equity and debt.

Which sectors or companies will lose out?

- Tobacco companies and companies in the coal business may find it tough to make the cut.
- Companies that generate hazardous waste and do not manage them properly will also suffer.
- Sectors that use a lot of water and do not follow best practices on its reuse will find it tough to get funds parked in them.
- Companies that discharge untreated waste in soil, water or air will also find it tough to get funds.

5.4 AT-1 Bonds

Why in news?

The Securities Exchange Board of India (SEBI) has restricted the small investors their access to AT-1 bonds.

What are AT-1 bonds?

- AT-1 bonds, short for Additional Tier-1 bonds, are innovative debt instruments.
- AT-1 includes perpetual non-cumulative preference shares and perpetual bonds.
- It is a type of unsecured, perpetual bonds that banks issue to shore up their core capital base to meet the Basel-III norms.

What are the new requirements?

- The SEBI has said that offers of such instruments should take the electronic book provider route, with participation restricted to QIBs.
- [QIBs - Qualified Institutional Buyers]
- The minimum ticket size for initial offers and secondary market trading in these bonds has been raised to ₹ 1 crore.
- Explicit disclosures will now be required on the perpetual character of these bonds.
- The Point-of-Non-Viability (PONV) clause that allows the RBI to direct a troubled bank to completely write-off the principal value.

Why these requirements are welcomed?

- These new requirements are a welcome attempt by the SEBI to ward off YES Bank-like situations.
- In YES Bank, the write-off of AT-1 bonds as a part of the bank's restructuring plan came as a shock to the hundreds of retail investors.
- This case brought into focus the widespread mis-selling of AT-1 bonds to retirees and low-risk investors by banks and intermediaries.

What are the loose ends?

- While SEBI's new rules will keep retail investors off these instruments, there are loose ends that need tying up.
- **Blocked out** - Now, a key category of investors called high net worth individuals are blocked out.
- So, the banks should compete with fewer buyers for their future AT-1 offerings at a time when sentiment towards these bonds has been soured by the YES Bank write-off.
- The RBI opened AT-1 bonds to retail investors a couple of years ago.
- It was done to broad-base demand and give public sector bank (PSB) bond offers a leg-up.
- **Impact on liquidity** - The increase in the minimum trading lot can impact secondary market liquidity.
- This will render these bonds less appealing to institutions.

- **Shooting up capital needs** - A shallow market for AT-1 bonds can hurt when Tier 1 capital requirements for PSBs may shoot up on the back of Covid-related provisioning.
- Fitch estimates banks' capital requirement at $15-58 billion in the coming year.

What should the regulators do?

- In this context, the SEBI and the RBI can evaluate if AT-1 bond participation can be opened up to **informed non-QIB investors**.
- [Non-QIB investors - Corporate treasuries and family offices with appropriate caveats.]
- The regulators also need to work out an **exit window**.
- This can be done through buybacks, for retail investors stuck in older AT-1 bonds with a current outstanding value of over ₹ 84,000 crore.
- The SEBI needs to initiate specific **penal actions** against intermediaries guilty of mis-selling.
- The RBI should **tighten its lax oversight of banks** acting as intermediaries for third-party products.
- SEBI's actions should serve as a wake-up call for the RBI to pay more serious attention to investor protection.

5.5 Forensic Audits

Why in news?

The Securities Exchange Board of India (SEBI) has made minor tweaks to different laws.

What has been changed?

- These tweaks could go a long way in strengthening the safeguards for public investors in listed shares and bonds.
- The most important of these is the requirement for all listed entities to make compulsory disclosures to the stock exchanges.
- It initiated any forensic audits into their books along with the reasons for commissioning them.
- On completion, the final audit reports along with management comments need to be filed with the exchanges too.

What does this move mean?

- This is a welcome move because the initiation of a forensic investigation and an explanation on whether it was initiated by the regulator or the company's own Board, is price-sensitive information.
- It has a bearing on one's decision to invest in a stock.
- Making full public disclosures of forensic audit reports as soon as they are submitted is essential too.
- This would do away with insider trading and stock price manipulation based on half-baked leaks from such reports.

What happened in the past?

- In the past, listed companies such as ICICI Bank and Infosys have seen sharp stock price volatility.
- This happened after whistle-blowers accused their top managers of governance infractions.
- Their Boards, after initiating internal forensic audits, claimed that the auditors had unearthed no irregularities citing selective extracts.
- DHFL, after a sting operation by a media outlet, commissioned a forensic study by an auditor who promptly gave it a clean chit.
- A subsequent audit commissioned by the regulator unearthed evidence of widespread diversion of loan funds.

What is the significance of public disclosure?

- Disclosing forensic audit reports to the public would remove all scope for selective interpretations.
- It allows analysts and investors in a company to make up their mind for themselves.
- Disclosing will prove instructive to investors and policymakers on the modus operandi used by fraudsters to divert public money.

What could be done?

- For better protection to bond and mutual fund investors, SEBI must extend the requirement on making forensic audit reports public to,
    1. Entities with listed shares,
    2. Entities with listed debentures and
    3. Entities dealing with public money in a fiduciary capacity — be it asset managers or rating agencies.
- The regulators such as SEBI and RBI should set an example by publishing the findings of these reports.

5.6 China's negative yield bonds

Why in news?

There is rising demand for Chinese negative yield bonds amidst of COVID Pandemic.

What are negative-yield bonds?

- They are debt instruments which pays the investor a maturity amounts lower than the purchase price of the bond.
- Investors buy them during times of stress and uncertainty to protect their capital from significant erosion.

Why is there a huge demand from investors across Europe?

- A 10-year and 15-year bond gives positive return in China whereas interest rates in Europe has dropped significantly.
- As against minus —0.15% yield on the 5-year bond issued by China, the yields offered in safe European bonds are much lower, between –0.5% and —0.75%.
- China is one country that is set to witness positive growth (GDP expanded by 4.9% in the third quarter of 2020) when large economies are facing a contraction in their GDP for 2020-21 in these challenging times.
- China demonstrated that it has controlled the spread of a second wave of Covid-19 cases when Europe, US and other parts of the world are still suffering.

What is the key factor driving this demand?

- After the pandemic global central banks injected massive amount of liquidity which shot up the prices of various assets including equities, debt and commodities.
- Investors wish to park their money in negative-yielding government debt for the purpose of hedging their risk portfolio in equities.
- The fresh wave of the Covid-19 pandemic can lead to further lockdown in the economies (new US government may impose), which can push interest rates down, yields reduces further, and leading to profits for investors.

6. EXTERNAL SECTOR

6.1 Investing in India

Why in news?

Prime Minister pitched India as an investment destination at the U.S.-India Strategic Partnership Forum.

What is the pitch?

- India is being pitched as an investment destination that could serve as a **manufacturing hub** at the heart of global supply chains.
- The pitch comes in the backdrop of the government's keenness to use the disruptions that the pandemic has caused to the cross-border movement of goods.
- India wants to use this opportunity to lure potential investors to India, especially those looking to relocate from China.
- This tack is consistent with recent initiatives to explore supply-chain synergies with other economies, including Japan.

What is the significance?

- Even if a few multinational enterprises can be drawn to set up manufacturing bases in India, the Indian economy will stand to gain FDI, new jobs and tax revenue.
- Officials must have advised Mr. Modi that U.S. businesses were the ideal target given the ongoing trade stand-off between US-China.
- On the face of it, the approach seems inarguably sound.

What are the friction factors?

- The rub lies in the government's recent 'Aatmanirbhar Bharat' initiative, of making India more **self-reliant**.
- Over the decades, the global FDI investors prioritised policy stability and largely barrier-free access to local and international markets.
- The drive for self-reliance has spurred Ministries to urge companies and industry sectors to replace imports with 'Made in India' substitutes.
- The thrust of the initiative is evidently '**import substitution**'.
- It is hard to imagine any potential foreign investor in manufacturing being ready to source capital goods locally.
- However, Mr. Modi stressed that the push for self-reliance shouldn't be interpreted as India turning its back on the world.
- India's decision to not join the RCEP trade pact would put investors who seek to tap RCEP member countries' consumers at a tariff disadvantage.

What could be done?

- Most of the recent FDI announcements have been by way of stake acquisitions in existing businesses, and mostly in the services sector.
- Attracting FDI into manufacturing will require the government to convince investors that it is committed not merely in words but in deeds.
- The **commitments** should be made in the aspects of an open, barrier-free global trade and investment order.

6.2 Amendments to FCRA

Why in news?

The Foreign Contribution (Regulation) Amendment Bill, 2020 was passed in the Parliament.

What is the Bill about?

- The Foreign Contribution (Regulation) Amendment Bill, 2020 seeks to amend the Foreign Contribution (Regulation) Act, 2010.
- The Act regulates the **acceptance and utilisation** of foreign contribution by individuals, associations and companies.
- Foreign contribution is the donation or transfer of any currency, security or article (of beyond a specified value) by a foreign source.

What are the provisions of the amendment?

- **Aadhaar for registration:** The Act states that a person may accept foreign contribution (FC) if they have:
    1. A certificate of registration from central government, or
    2. Prior permission from the government to accept FC.
- The Bill adds that person seeking prior permission, registration or renewal must provide the Aadhaar number of all its office bearers, directors or key functionaries, as an identification document.
- In case of a foreigner, they must provide a copy of the passport or the Overseas Citizen of India card for identification.
- **Prohibition to accept foreign contribution:** Under the Act, certain persons are prohibited to accept any foreign contribution.
- These include: election candidates, judges, government servants, members of any legislature, and political parties, among others.
- The Bill adds public servants (as defined under the Indian Penal Code) to this list.
- **Transfer:** The Act states that FC cannot be transferred to any other person unless such person is also registered to accept it.
- They should have obtained prior permission under the Act to obtain FC.
- The Bill amends this to prohibit the transfer of FC to any other person.
- **FCRA account:** The Act states that a person can accept FC only in one branch of a scheduled bank specified by them.
- But, they may open more accounts in other banks for utilising the FC.
- The Bill states that FC must be received only in an account designated by the bank as “FCRA account” in such branch of the SBI, New Delhi, as notified by the central government.
- No funds other than FC should be received or deposited in this account.
- The person may open another FCRA account in any scheduled bank of their choice for utilising the received contribution.
- **Restriction in utilisation:** Under the Act, if a person violates the provisions of the Act, the unutilised or unreceived FC may be utilised or received, only with the prior approval of the central government.
- The Bill adds that the government may restrict usage of unutilised FC for persons who have been granted prior permission to receive such FC.
- **Renewal of license:** Under the Act, every person must renew the certificate of registration within six months of expiration.

- The Bill provides that the government may conduct an inquiry before renewing the certificate of registration.
- **Reduction in use of FC for administrative purposes:** Under the Act, a person who receives FC must use it only for the purpose for which the contribution is received.
- Further, they must not use more than 50% of the contribution for meeting administrative expenses. The Bill reduces this limit to 20%.
- **Surrender of certificate:** The Bill allows the central government to permit a person to surrender their registration certificate.
- The government may do so if, post an inquiry, it is satisfied that such person has not contravened any provisions of the Act.

What is the concern?

- Amendments to the FCRA were drafted without consultation with stakeholders.
- They were passed with limited discussion in Parliament which further clips the wings of India's battered civil society.
- They put heavy conditions on civil society organisations, and educational and research institutions that have partnerships with foreign entities.
- The International Commission of Jurists said that the new law was incompatible with international obligations and India's constitutional provisions on rights.

What was the allegation?

- In Parliament, the ruling party alleged that the foreign money was being used for religious conversions.
- The debate on religious propagation and conversions must be delinked from the question of foreign funding.
- There are adequate laws against conversion by inducement.
- The right or wrong of it cannot be decided against the touchstone of the source of funds, native or foreign.
- Some of the restrictions appear well meaningful, but could impact NGOs besides showing up India to be overregulated.

What is needed?

- It could be true that a portion of such foreign assistance may be reaching the wrong hands.
- But, a presumption of guilt against the NGOs, followed by control, amounts to throwing the baby out with the bathwater.
- Seamless sharing of ideas and resources across national boundaries is essential to the functioning of a global community.
- This should not be discouraged unless there is reason to believe that the funds are being used to aid illegal activities.

7. GENERAL ECONOMY

7.1 Halt of 'Doing Business' Report

Why in news?

The World Bank halted its annual 'Doing Business' report, as it detected irregularities of data for a few countries.

Should India bother about it?

- Yes. India has sought to improve its doing business index ranking, as a means to attract investments to achieve the targets set for 'Make in India'.
- This initiative, announced in 2014, aims at:
    1. Raising the manufacturing sector's share in Gross Domestic Product (GDP) from 16-17% to 25% and
    2. Creating 100 million additional jobs in the manufacturing sector by 2022.
- India's success in boosting its ease of doing business ranking from the 142nd rank (2014) to 63rd rank (2019) is spectacular.
- The WB decision to audit the last five years' reports may soon cause discomfort by shining a spotlight on the sharp rise in India's ranking.
- In 2018, a study by the Center for Global Development (CGD) found that the improvement in India's ranking was almost entirely due to methodological changes.

What is the case of Chile?

- Chile's global rank went down sharply, from 34 (in 2014) to 67 (in 2017).
- Chile's former President (2014-18) accused the WB of manipulating the index methodology to show her presidency in poor light.
- The CGD study of March 2018, with a reworking of the ranks with an unchanging methodology showed very little change in Chile's global rank.

How did the WB respond?

- In 2017, World Bank's Chief Economist, Paul M. Romer admitted to the World Bank's mistakes.
- The contrasting experience of Chile and India casts doubts on the country-level data and also the changes in underlying methodologies.
- Therefore, the WB decision to suspend the publication and conduct a systematic review of the reports of the last five years is welcome.

Does the index have predictive power?

- Recent evidence about India is telling.
- While its rank pole vaulted, it has meant nothing on the ground.
- The share of the manufacturing sector has stagnated at 16-17% of GDP, and 3.5 million jobs were lost between 2011-12 and 2017-18.
- Annual GDP growth rate in manufacturing fell from 13.1% in 2015-16 to zero in 2019-20, as per the National Accounts Statistics.
- India's import dependence on China has shot up, compelling India to announce yet another initiative — Atmanirbhar Bharat.

What are the shortcomings of the index?

- There are many shortcomings in the **design and implementation** of the index.
- The Indicators used for the index are **de jure** (as per the statute), not de facto (in reality).
- The data for computing the index are obtained from larger enterprises in two cities, Mumbai and Delhi, not from entrepreneurs.
- These data are obtained by lawyers, accountants and brokers.
- The WB conducts a global enterprise survey collecting information from companies.

- Interestingly, there is **no correlation** between the rankings obtained from ease of doing business and the enterprise surveys.
- The **theoretical underpinning** of the index is suspect.
- There is little in any major strand of economic thought which suggests that minimally regulated markets for labour and capital produce superior outcomes in terms of output and employment.
- Economic history shows rich variations in performance across countries and policy regimes that defies the index's simplistic generalisations.
- But, such simplistic homilies are used under a seemingly scientific garb of the quantitative index to the disadvantage of workers.
- For instance, to meet the ease of doing business targets, safety standards of factories are compromised.

What could be done?

- The WB's decision to halt its annual report on account of data authenticity issues of some countries has implications for India.
- Since 2015, the government has invested political and administrative capital to improve India's global ranking, with impressive success.
- But the enhanced ranking has failed to augment investment and output growth.
- So, it is time the World Bank **rethinks its institutional investment** in producing the 'Doing Business' report.
- India should do some **soul searching** as to why the much trumpeted rise in global ranking has failed miserably on the ground.

7.2 EoDB Rankings for Indian States

Why in news?

The latest ease of doing business rankings for Indian states was released by the Department for Promotion of Industry and Internal Trade (DPIIT).

What is the objective?

- The objective of DPIIT's reform exercise is to provide a business-friendly environment.
- For this, regulations in a state have to be made simpler.
- Therefore, the DPIIT devised a methodology to rank the states according to the ease of doing business (EoDB) in a state.
- DPIIT provides a set of recommendations to reduce the time and effort spent by businesses on compliance with regulation called the Business Reform Action Plan (BRAP).

What is the BRAP?

- BRAP 2019 is an 80-point list of reforms recommended to simplify, rationalise and digitise the regulatory framework in a state.
- The reforms are grouped into 12 broad areas like land administration, labour regulation, environment regulation, obtaining permits, etc.

How are the rankings arrived at?

- States are required to submit proof of implementing each reform on the DPIIT's EoDB portal and submit a list of users of these reforms.
- A sample of these users is surveyed to determine these reforms' efficacy.

- Each question is assigned a weight.
- The final score is a weighted average of all the responses applicable to a state.

What reforms does DPIIT recommend?

- It recommends all states have a single-window system that provides all information on permits and licences required for starting a business.
- Permissions required from municipal or village government bodies or police for activities like filming movies should be explicitly mentioned.
- DPIIT recommends that the duration of licences be extended or that they be renewed automatically based on self-certification or third-party verification.
- A state is rewarded if a set of regulations (like labour or environment laws) are not applicable to it.

How did the states perform?

- Andhra Pradesh secured the top spot for the third time since the ranking was first released in 2015.
- UP jumped ten spots to number two and Telangana slipped to three.
- Gujarat, which was first in the first-ever edition, was ranked 11 this year.
- Haryana slipped all the way to 17.

Are these scores comparable to those from previous years?

- For the first time, the BRAP rankings relied entirely on the feedback it received from the businesses for whom these reforms were intended.
- Earlier editions computed scores based on the responses of the relevant state government departments.
- The 2017-18 edition used a combination of state government and user feedback to compute the score.
- So, the 2019 rankings are not comparable with those from last year.

Why were these rankings criticised?

- DPIIT'S methodology does not consider the actual number of reforms implemented by the states.
- States like Haryana and Gujarat have implemented all the reforms recommended by the DPIIT, but were ranked low on the EoDB list.
- DPIIT's methodology awards points on a reform to a state only if there was an adequate response from users of that response.
- Ideally, the number of respondents for every state should be decided based on population or number of business clusters to ensure that the sample is representative of the state.
- It is not clear if DPIIT used representative samples.
- Also, business owners' expectations from the governments can differ.

How do these reforms affect investments?

- An analysis shows that the top-ranking states have not necessarily been associated with higher shares of new investments announced during the year.
- Except for Andhra Pradesh, the top-ranking states as per these rankings do not have high shares in the total investment during the year.
- This is because businesses respond to other conditions like the availability of skilled labour, infrastructure, finance, etc.
- In addition, these rankings do not consider the cost of doing business.

7.3 PLI scheme

Why in news?

The government aims to expand the ambit of the production-linked incentive (PLI) scheme to include ten more sectors.

What is the PLI scheme?

- The scheme aims to give companies incentives on incremental sales from products manufactured in domestic units.
- The central government introduced this scheme to boost domestic manufacturing and cut down on import bills.
- Apart from inviting foreign companies to set shop in India, it encourages local companies to set up or expand existing manufacturing units.

What is the objective?

- The objective is to make India more compliant with the WTO (World Trade Organisation) commitments.
- Another objective is to make it non-discriminatory and neutral with respect to domestic sales and exports.

Which sectors currently have the PLI scheme?

- So far, the scheme has been rolled out for mobile and allied equipment, pharmaceutical ingredients and medical devices manufacturing.
- These sectors are labour intensive and are likely to create new jobs for the ballooning employable workforce of India.

Why is the PLI scheme needed?

- It is important as the government cannot continue making investments in the capital intensive sectors.
- This is because they need longer times for start giving the returns.
- Instead, the government can invite global companies with adequate capital to set up capacities in India.

Which sectors would have the PLI scheme in the near future?

- The government would introduce PLI scheme in about ten sectors, apart from the two already existing ones.
- The likely candidates are food processing, textiles, leather as well as battery manufacturing.

What would be the similarity and difference?

- Like existing PLI schemes, the new sectors could see the government offering them sops and bonuses for incremental sales done.
- However, the previous schemes were brought to boost domestic manufacturing.
- The new one aims to give all the sops and benefits only if the companies are able to prove that they had incremental sales every year for the next five years.

7.4 World Economic Outlook

Why in news?

The International Monetary Fund (IMF) has released its latest World Economic Outlook.

What are the projections?

- The report titled 'A long and difficult ascent' sums up the economic challenges ahead.

- The IMF's economists have sought to make forecasts for world output through 2020, 2021 and into the medium term.
- The global economy is projected to shrink 4.4% this year, reflecting a less severe contraction than the 5.2% drop estimated in June.
- The output is seen rebounding at a marginally slower 5.2% pace in 2021.
- The IMF has based its revision on better-than-anticipated second-quarter GDP out-turns, mostly in advanced economies.
- It is also based on the signs of a stronger recovery in the July-September quarter.

What are the concerns?

- The IMF pointed out that even as the world economy ascends out of the depths it plunged into (due to the pandemic-led lockdown), there remains the danger of resurgence in infections.
- This danger is prompting European countries to reimpose at least partial closures.
- There are certain factors which magnify the uncertainty.
- The factors include the risks associated with predicting the pandemic's progression, the unevenness of public health responses, and the extent to which domestic activity can be disrupted.

What will be the impact of the pandemic?

- The IMF's Chief Economist pointed out that the pandemic is set to leave scars well into the medium term as the,
    1. Labour markets take time to heal,
    2. Investment is held back by uncertainty and balance sheet problems, and
    3. Lost schooling impairs human capital.
- The global growth will gradually slow to about 3.5% in the medium term.
- The cumulative loss in output relative to the pre-pandemic projected path estimated to more than double to $28 trillion over 2020–25.
- So, the efforts to improve average living standards are certain to be severely set back.

What is needed?

- The IMF observed that the pandemic is set to widen inequality between economies and within nations.
- So, the IMF has urged greater **international cooperation**.
- It is imperative for all countries to work closely to ensure that new treatments and vaccines are made available to all.
- This is because wider and faster **availability of medical solutions** could boost global income by almost $9 trillion by end-2025.

What could be done for now?

- With no visibility yet on vaccine availability, the IMF has also stressed the need for policymakers to persist with,
    1. Direct income support for the most vulnerable and
    2. Regulatory forbearance for stressed but viable firms.
- In a world as interconnected as it is today, the cost of economic insularity would only be more protracted pain for all.

7.5 Refining Trade Union Strategies

Why in news?

- Ten central trade unions (CTUs) had called for a nation-wide strike to condemn what they consider to be the anti-people and anti-labour economic policies of the government.
- This follows strikes in the coal and defence sectors protesting privatisation and the corporatisation policies of the government.

What is the rationale for changes in labour laws?

- With the 1991 economic reforms, employers and the global financial institutions have been demanding labour market and structural reforms.
- The reform processes gained momentum since 2015 and the central government has enacted four Labour Codes in the last 2 years.
- The Codes are based on the premise that labour laws and inspection system are obstacles in attracting investment.
- Hence, the government is inclined to promote a cheaper and flexible labour market.

What is the contention now?

- The Codes do extend some labour rights such as -
    i. universal minimum wage
    ii. statutory recognition of trade unions
    iii. formalisation of employment contracts
    iv. social security to gig and platform economy workers
- However, they also afford substantial flexibility to the employers.
    - This comes in terms of easy hire and fire, freedom to hire contract labour and unregulated fixed-term-employment, etc.
- The Codes have also considerably redefined the concept and practice of labour inspection system by diluting it.

What is the post-COVID scenario?

- Many factors have created tremendous insecurity among workers including -
    i. the labour Codes
    ii. reduction of expenditure by the state in the industrial sector and fiscal conservatism, especially in the context of higher levels of unemployment
    iii. stubborn inflation
- Migrant and informal workers underwent woeful experiences during the COVID-19 period.
- The central government and several State governments had seen this as an opportune time to enact labour law reforms.
- But these have far-reaching adverse consequences for labour rights and structural reforms.
- The Farm Bills and the three Labour Codes during the COVID-19 period were passed with Parliament not witnessing “healthy discussions”.
- Trade unions contend that many of their suggestions have not been incorporated in the Codes and the COVID-19 relief measures.

What is the way forward for the trade unions?

- The Codes are set to rule the industrial relations system for long unless the government changes.
- In the present context, trade unions have six options to confront or soften the government measures that concern them.
  - These are social dialogue, political lobbying, political confrontation through Opposition parties, legal action by approaching the judiciary, seek the International Labour Organization's intervention, and direct industrial action.
- **Industrial action -** Trade unions are now left with the option of demonstrative "industrial action" followed by sustained protest actions.
- It is in this context that the central trade unions (except the BMS and its allies) have the following demands:
  1. direct cash transfer of Rs. 7,500 per month for all non-income tax-paying families
  2. 10 kg free ration per person per month to all the needy
  3. expansion of MGNREGA to provide 200 days of work in a year in rural areas at enhanced wages
  4. extension of employment guarantee to urban areas
  5. withdrawal of all anti-farmer laws and anti-worker labour codes
  6. a halt to privatisation
  7. protection of government employment
  8. restoration of old pension schemes, etc
- Beyond strikes, the Trade unions must explore other avenues such as seeking the ILO's intervention, judicial action and social dialogue.
- **Judiciary -** The judiciary could be a source of hope for addressing the issue.
- The Supreme Court of India did not respond quickly to provide relief to migrant workers.
- Nevertheless, it has struck down the Gujarat government's amendment of the Factories Act.
- Unions must shed their judicio-phobia and approach it provided they have strong legal grounds to challenge the reforms introduced.
- **ILO -** Trade unions, out of their patriotic mindset, do not use extensively the complaints mechanism created by the International Labour Organization.
- But they did seek ILO intervention recently.
- However, the ILO's intervention in May 2020 only provided a temporary respite to trade unions as the government did what it has been doing.
- **Social Dialogue -** All the parties in the industrial relations system must make effective use of social dialogue, which is a better alternative in a pluralistic democracy.
- Suitable amendments to the Codes should aid both ease of doing business and promote labour rights.

7.6 Code on Wages

What is the issue?

- In the monsoon session of Parliament, three new labour codes were bulldozed into passing and now await the President's assent.
- Labour Minister told that four new labour codes, including the Code on Wages, will become operational before the year ends.

What is the Code on Wages, 2019?

- The Code on Wages, 2019 seeks to consolidate and simplify four pieces of legislation into a single code. The legislations are,
  - a) Payment of Wages Act, 1936,
  - b) Minimum Wages Act, 1948,
  - c) Payment of Bonus Act, 1965 and
  - d) Equal Remuneration Act, 1976.
- Its object and reasons stated that the 2nd National Commission on Labour, 2002 suggested consolidating all labour laws into four codes.

Why rules will be framed?

- While the previous four pieces of legislation had a total of 119 sections, the new Code has 69 sections.
- Considering that the repealed legislations each had a definition section, inspectors, penalties, etc, any consolidation will impact their length.
- All requirements for enforcing the Act have been relegated to the Rules.
- Section 67 had authorised the framing of rules relating to as many as 38 provisions of the Act.
- As a result, the delegated rules will be bigger than the Code.
- This is no way to condense prior pieces of legislation.

What problems will arise?

- Combining the four repealed pieces of legislation into a single code will create new set of problems.
- Barring a few new concepts, the new Code retains almost all provisions.
- **Worker** - The Code will have the same definition of the term “worker”.
- But, a person employed in a supervisory capacity drawing up to ₹ 15,000 will also be considered a worker.
- **Wage fixing** - In the Minimum Wages Act, to fix minimum wage in an employment which has more than 1,000 workers to be first included in the Schedule, and then, minimum wages will be fixed as per law.
- The Code has dispensed with the necessity of having a minimum number of workers and the inclusion of such employment into the schedule.
- **Floor wage** - The central government will fix a “floor wage”.
- Once it is fixed, State governments cannot fix any minimum wage less than the “floor wage”.
- It is unwarranted since many States always fix minimum wages higher than the existing rates.
- The concept should be for a binding minimum wage and not have dual wage rates — a binding floor wage and a non-binding minimum wage.

What is the conflict?

- There was a conflict between the minimum wages fixed by the State governments for agriculture workers.
- There were cases as to whether the Minimum Wages Act would have an over-riding effect over the provisions of the MGNREGA, 2005.
- [MGNREGA - Mahatma Gandhi National Rural Employment Guarantee Act]
- That has been set to rest by excluding MGNREGA from the purview of the Code on Wages.

Who is an inspector-cum-facilitator?

- The Code has created an omnibus inspector-cum-facilitator who will act as per the inspection scheme framed by the government.
- He will advise employers and workers to comply with the provisions of the code.
- As per Section 51, he may carry out inspections as may be assigned by the government.

What are the provisions regarding claim mechanism?

- Section 45 stipulates that the claims will be heard by an authority who is not below the rank of a "Gazetted Officer".
- A government official without legal and administrative background can hear such claims.
- However, any dispute regarding bonus will continue to go before the Industrial Tribunal.
- One can appeal to an appellate authority who must be one rank higher than the competent authority (Section 49).
- Neither the Code nor the Rules prescribe the qualifications and experience required for appointment of competent authority.

What are the provisions on penalty?

- The penal provisions found hitherto in any pieces of labour legislation never had an impact on employers.
- In Asiad case, 1982, the Supreme Court observed that if violations of labour laws are going to be punished only by meagre fines, the labour laws would be reduced to nullity.
- But, Section 52 has been introduced where an officer (not below the rank of an undersecretary to the government) will impose a penalty in the place of a judicial magistrate.
- A similar provision of the Bonded Labour System (Abolition) Act, 1976 was struck down by the Division Bench of the Madras High Court (2014).
- The Bench had observed that the Executive Magistrate has no role to play in conducting judicial trial and recording judicial decisions.

What are the exemptions made?

- The Code exempts employers from penal provisions if they prove that they had used due diligence in enforcing the execution of the code.
- They should also prove that it was the other person who had committed the offence without his knowledge, consent or connivance.

Will there be an impact?

- There is nothing particular in this Code that will expand the coverage of workers in all industries in the unorganised sector.
- While there were 10,000 slabs of minimum wages that existed, they would now be reduced to 200 slabs.
- The 200-slab categorisation may not have much of an impact.
- The Code on Wages has not succeeded in a consolidation of laws.

7.7 Relaxation of Rules for Other Service Providers

Why in news?

The Centre relaxed the rules for governing Other Service Providers

What were the previous rules?

- The existing rules governing the outsourcing companies were introduced in 1999 when the telecom sector was highly regulated.
- The Centre wanted to keep a tab on the voice traffic flowing within various call centres.
- By doing so, it wanted to ensure that no one infringed on the jurisdiction of telecom service providers.

What are the new rules?

- Under the new rules, non-voice processes have been kept out of the definition of other service providers.
- Even for voice-based call centres, there is no registration or reporting requirement.
- Other requirements such as deposit of bank guarantees, requirement for static IPs, publication of network diagram, frequent reporting obligations, penal provisions have been removed.

How has the pandemic affected the ITeS Companies?

- The pandemic has increased the pace of technology adoption as clients and their customers move to a digital environment.
- Digital transformation and migration to the cloud have become the need of the hour.
- More than 85% employees of IT companies function from home.
- From a centralised architecture, IT services companies have had to restructure their entire organisation.

How will the current move help?

- The new rules for Other Service Providers (OSPs) seek to create a friendly regime for 'Work from Home' and 'Work from Anywhere'& removing frequent reporting obligations of companies.
- It makes accessing and maintaining data from remote places easier and quicker.
- The costs related to real estate and managing offices will go down.
- This will help in creation of jobs in smaller cities.
- In the old business model, talent had to be relocated from their hometown.
- Now, a qualified person does not have to migrate to work in an MNC.
- Another benefit is the boost it will give to the gig economy.

7.8 RCEP Trade Deal

Why in news?

The Regional Comprehensive Economic Partnership (RCEP) trade deal was signed.

What is RCEP?

- RCEP deal is the largest regional trading agreement to this day.
- The purpose of RCEP was to make it easier for products and services of each of these countries to be available across this region.
- Negotiations to chart out this deal had been on since 2013.
- It is signed by 15 countries led by China, Japan, South Korea, Australia, New Zealand and the 10-state ASEAN grouping.
- [ASEAN - Association of Southeast Asian Nations]
- India decided to exit the grouping in 2019.

What is the comparison with the TPP?

- Many say that RCEP is not likely to usher in comprehensive economic integration in East Asia, as like the Trans-Pacific Partnership (TPP).
- TPP would have been the world's most extensive FTA in terms of market opening had the Trump Administration decided not to abandon it.
- But there have been doubts whether the TPP was a highly discriminatory managed trade.
- TPP had several regulatory issues including the controversial labour and environmental standards and issues such as "anti-corruption".
- All these could raise regulatory barriers and severely impede trade flows.
- In contrast, RCEP includes traditional market access issues, following the template provided by the World Trade Organization (WTO).
- It also includes issues that are being discussed by several WTO members as a part of their agenda to reform the multilateral trading system.
- The issues are electronic commerce and investment facilitation.

What are the problems?

- In case of trade in goods, RCEP members have taken big strides towards lowering their tariffs.
- But, the commitments made by the RCEP members for services trade liberalisation look shallow in terms of the coverage of the sectors.
- **Movement of natural persons**, an area in which India had had considerable interest, is considerably restricted.
- RCEP members have allowed relatively limited market access only to individuals in managerial positions or those having high levels of skills.
- India had expressed its reservations on template adopted during RCEP negotiations on the areas of investment and electronic commerce.
- The text on **investment rules** shows that it is a work-in-progress.
- It will be interesting to see whether the controversial investor-state-dispute-settlement (**ISDS**) mechanism is included.
- In case of **electronic commerce**, RCEP members have agreed not to prevent cross-border transfer of information by electronic means where such activity is for the conduct of the business of a covered person.
- However, a member can deny transfer of information if it is necessary to achieve a legitimate public policy objective.
- Members can adopt a legal framework which ensures the protection of personal information of the users of electronic commerce.

Why did India exit the grouping?

- India had justified its decision as protecting its economy from burgeoning trade deficits with a majority of the 15 RCEP members.
- It wanted to safeguard the interests of industries like agriculture and dairy and to give an advantage to the country's services sector.
- The grouping's refusal to accede to India's requests on safeguards was a deal breaker.

How far is China's presence a factor?

- Escalating tensions with China are a major reason for India's decision.

- The various measures India has taken to reduce its exposure to China would have sat uncomfortably with its commitments under RCEP.
- Major issues that were unresolved during RCEP negotiations were related to the exposure that India would have to China.
- **Rules of origin -** It is the criteria used to determine the national source of a product.
- India felt that there could be a possible circumvention of rules of origin.
- In that case, some countries could dump their products by routing them through other countries that enjoyed lower tariffs.
- This may lead to surges in imports.
- India feared that there were inadequate protections against these surges.
- **MFN** - India also wanted RCEP to exclude most-favoured nation (MFN) obligations from the investment chapter.
- **Other issues** - India felt the deal would force it to extend benefits given to other countries for sensitive sectors like defence to all RCEP members.
- RCEP also lacked clear assurance over market access issues in countries such as China and non-tariff barriers on Indian companies.
- Also, the final agreement shows that the pact does address these issues.

What are India's options now?

- India is an original negotiating participant of RCEP.
- It has the option of joining the agreement without having to wait 18 months as stipulated for new members in the terms of the pact.
- Alternatively, India may be reviewing its existing bilateral FTAs with some of these RCEP members.
- It will also make newer agreements with other markets with potential for Indian exports.
- Over 20 negotiations, including with the US and the UK, are underway.

Can India re-engage with RCEP?

- Prior to the signing of the deal, RCEP has left the door open for India to join RCEP Agreement as an original signatory.
- India has been invited to participate in RCEP meetings as an observer and in economic cooperation activities undertaken by RCEP members.
- RCEP members may commence negotiations with India once India submits a request in writing of its intention to accede to the agreement.

Will India choose to re-engage?

- The answer seems to be unambiguously in the negative on two counts.
- **Concerns raised** - During the RCEP negotiations, India had raised a number of concerns, two of which, include,
    1) The levels of market access it was expected to provide, especially the deep cuts in tariffs on imports from China, and
    2) Provisions relating to the investment chapter.
- Since the border clashes, India has imposed a number of import restrictions on Chinese products.
- Both these measures would have been infructuous if India were a party to the RCEP.

- **Atmanirbhar Bharat Abhiyan,** India's initiative for its economic turnaround, is mainly focused on strengthening domestic value chains.
- But the RCEP, like any other FTA is solely focused on promoting regional value chains.

7.9 Land Monetisation

What is the issue?

- The central and state governments are facing revenue crisis.
- So, the monetisation of land is a viable option for public sector undertakings and urban local bodies.

What is Land Monetisation?

- Asset monetization is basically a transaction that converts a dead/idle asset into an income generating one.
- Land monetisation will enable the retention of land ownership while realising market rent (if the revision of rent is periodic and on agreed principles).
- For example, government-run company MTNL has a reported 250 acres of land in Delhi & Mumbai.
- Partnering with a company that can help lease the office space to companies could help MTNL with a healthy annuity income.
- It should be a well-thought process, weighing the potential benefits and viability.

Why is it a viable option?

- It will generate a revenue stream and also entails several other benefits.
- It puts the land to better use.
- The commercial development of land accelerates the real estate prospects in the vicinity.
- It will fuel the demand for social infrastructure such as retail development, banking, etc.
- It also contributes to planned urbanisation, boosts tourism and generates employment.
- It has cascading effects on economic development and the quality of life of citizens.
- Land exchange/swap can also be used as an instrument if suitable options for exchange exist with any other government entity.

How can it be done efficiently?

- A process needs to be set up by which detailing the land assets for all government organizations should be undertaken.
- Once a detailed list of all such assets can be streamlined, it will help bring transparency to the process.
- Only after a thorough mapping, will the question of what can be monetized come up.
- Consulting companies could then get involved in the process so that the type of "value that can be unlocked" can be detailed for different parcels of land.
- These could be the very foundation on which public/private participation could be sought.
- Mass sensitisation and awareness programmes should be organised for the local community to educate them on the benefits of the process.

What is the challenge?

- The major hurdle is the time-consuming process of approvals from the various civic authorities.
- The confidence-building measures for the revival of the economy post-Covid-19 need to be supplemented by fast-tracking the approval processes.

7.10 Global Hunger Index

Why in news?

The Global Hunger Index (GHI) 2020 has placed India at rank 94 among 107 countries.

What is the GHI?

- The GHI has been brought out every year by Welthungerhilfe (lately in partnerships with Concern Worldwide) since 2000.
- A low score gets a country a higher ranking which implies a better performance.
- The reason for mapping hunger is to ensure that the world achieves "Zero Hunger by 2030" - a Sustainable Development Goals of the UN.
- This is why GHI is not calculated for certain high-income countries.

What are the four indicators of GHI?

- **Undernourishment** reflects the inadequate food availability.
- It is calculated by the share of the population that is undernourished (i.e., whose caloric intake is insufficient).
- **Child Wasting** reflects acute under nutrition.
- It is calculated by the share of children under the age of five who are wasted (i.e., those who have low weight for their height).
- **Child Stunting** reflects chronic under nutrition.
- It is calculated by the share of children under the age of five who are stunted (i.e., those who have low height for their age).
- **Child Mortality** reflects both inadequate nutrition and unhealthy environment.
- It is calculated by the mortality rate of children under the age of five (in part, a reflection of the fatal mix of inadequate nutrition.

How is the score calculated?

- Each country's data are standardised on a 100-point scale.
- A final score is calculated after giving 33.33% weight each to components 1 and 4, and giving 16.66% weight each to components 2 and 3.
- As GHI tracks the performance of different countries on four key parameters, it provides a far more comprehensive measure of hunger.

What is India's position?

- The GHI 2020 places India at **rank 94** among 107 countries.
- The unedifying assessment of the national situation as "**serious**".
- The country's **score of 27.2** is the worst among BRICS countries.
- It is inferior to Pakistan, Sri Lanka, Bangladesh and Nepal.

What does this position mean?

- India's poor progress on nutritional indices must dismiss the pride surrounding strong economic growth for years.
- It turns the national focus on persisting hunger, wasting and stunting among children.

What is the evidence?

- The evidence from the National Family Health Survey-4 (NFHS-4) of 2015-16 is not very different.

- The national policy has no appetite for a radical transformation in the delivery of adequate nutrition especially to women and children.
- It has paid inadequate attention to achieving diet diversity through the PDS.
- On the other hand, the country is widely seen as falsely equating energy calories with a diverse diet.
- The existing deprivation has been aggravated by the pandemic, with food inflation putting pressure on depleted or meagre incomes and savings.

What did the NFHS-4 find?

- It found that under-five stunting stood at 38%, and wasting at 21%.
- These data represent some progress, at a drop of about 10 percentage points in both categories compared to a decade earlier.
- But steady economic prosperity should have yielded a far bigger social dividend.
- The latest GHI measure reminds us that much work is needed to bring the true benefits of the National Food Security Act to the unreached.
- Efforts should be made to not merely mitigate hunger through cereals, but as nourishment through a diverse diet.

What needs to be done?

- Strengthening the PDS, with a focus on women's health, would lead to healthier pregnancies.
- Stronger supplemental nutrition under the ICDS scheme would give children a better chance at all-round development.
- International Food Policy Research Institute's recent findings say that three out of four rural Indians cannot afford a balanced, nutritious diet.
- This underscores the importance of immediate sustained intervention.
- The right to food would be meaningless if it leaves a large section of Indians hungry, stunted and wasted.

8. INFRASTRUCTURE

8.1 Telecoms and AGR Dues

Why in news?

The Supreme Court held that telecom firms will get 10 years to clear their adjusted gross revenue or AGR dues.

What did the Supreme Court rule on AGR dues?

- The Supreme Court (SC) gave all telcos a 10-year timeline to complete the payments of AGR dues.
- [Previously, there was 20-year schedule suggested by the Department of Telecommunications (DoT).]
- The court also directed telcos to pay 10% of the total AGR dues by March 31, 2020.
- Following this, they can make payments in annual instalments between 2021 and 2031.
- The non-payment of dues in any year would lead to accrual of interest and invite contempt of court proceedings against such companies.
- The issue of whether the spectrum could be sold under Insolvency and Bankruptcy Code will now be decided by the National Company Law Tribunal.

What is the AGR issue?

- All the telecom companies that operate in India pay a part of their revenues as licence fee and spectrum charges to the DoT.
- This is charged for using the spectrum owned by the government.
- In its definition of AGR, the DoT had said that telcos must cover all the revenue earned by them, including from non-telecom sources.
- The telecom companies had challenged this definition of AGR in several forums, including the Supreme Court.

What was the 2019 SC verdict?

- In 2019, the SC had upheld the DoT's definition of AGR.
- It also said that since the licensee had agreed to the migration packages, they were liable to pay the dues, the penalty on dues, and the interest on penalty due to delay in payments.
- The SC had then given the telcos three months to clear their AGR dues.
- The telcos sought a review of the judgment.
- However, it was dismissed by the SC which had then insisted that telcos clear all the dues by January 23, 2020.

Why did the SC extend the payment timelines?

- The DoT and, the telcos that needed to pay within such a short period of time requested a hearing from the SC.
- The court agreed to hear them on a revised timeline, but it refused to reconsider the quantum of AGR to be paid by them.
- In an affidavit to the SC, the DoT had suggested that telcos be given up to 20 years to complete the payment of pending dues.
- The DoT suggested that these dues could be paid by the telcos in annual installments.
- It suggested that the interest on the past unpaid amount, penalty and the interest on penalty with respect to past dues, be frozen as of October 24, 2019.

What does the AGR ruling mean for telcos?

- For Bharti Airtel and Vodafone Idea, a payment timeline of 10 year will come as a breather.
- Both the companies had sought 15 years for making the AGR payment.
- Some telcos will suffer as the SC has not allowed any recalculation of dues.

8.2 Green-Blue Policy

Why in news?

The Green-Blue policy is the focus of the Master Plan for Delhi 2041.

What is Master Plan for Delhi 2041?

- The Delhi Development Authority (DDA) is holding public consultations for the preparation of the Master Plan for Delhi 2041.
- It is a vision document for the city's development over the next two decades.
- The existing Master Plan 2021 will be outdated next year.
- The agency wants to notify the new plan by the time that happens.

- The draft policy's focus on water bodies and the land around it, which is referred to as the "Green-Blue policy", would give the city a new shape.

What is Green-Blue infrastructure?

- 'Blue' infrastructure refers to water bodies like rivers, canals, ponds, wetlands, floodplains, and water treatment facilities.
- 'Green' infrastructure stands for trees, lawns, hedgerows, parks, fields, and forests.
- The concept refers to urban planning where water bodies and land are interdependent, and grow with the help of each other.
- They will offer environmental and social benefits.

How does DDA plan to go ahead with it?

- The DDA plans to deal with the multiplicity of agencies, which because of the special nature of the state, has plagued it for several years.
- It wants to map out the issues of jurisdiction, work being done by different agencies on drains, and the areas around them.
- Thereafter, a comprehensive policy will be drawn up, which would then act as the common direction for all agencies.

What is the plan for redevelopment?

- Delhi has around 50 big drains (blue) managed by different agencies.
- Due to their poor condition and encroachment, the land around them (green) has also been affected.
- The DDA, along with other agencies, will integrate them.
- They will remove all sources of pollution by checking the outfall of untreated wastewater as well as removal of existing pollutants.
- A mix of mechanised and natural systems may be adopted.
- Dumping of solid wastes in any of these sites will be strictly prohibited by local bodies, through the imposition of penalties.

What will the areas look like after redevelopment?

- Land around these drains, carrying storm water, will be declared as special buffer projects.
- A network of connected green space would be developed in the form of green mobility circuits of pedestrian and cycling paths.
- There is a plan to develop spaces for yoga, active sports (without formal seating), open air theatres, and other low impact public uses.
- The nature of use, extent of public access, type of vegetation, etc. shall be ascertained on a case-to-case basis through scientific assessments.
- Real estate would be developed along these integrated corridors.

What are the challenges?

- The biggest challenge here is the **multiplicity of agencies**.
- DDA wants to bring together different agencies like Delhi Jal Board, Flood and Irrigation Department, and municipal corporations as stakeholders in the project.
- In a city where even waterlogging turns into a blame game between different agencies, this will be a tough task.

- It will be tough, especially as the DDA has no supervisory power over these bodies.
- **Cleaning of water bodies** and drains has been a challenge for agencies in Delhi for years now.
- An IIT-Delhi report on 20 major sewer drains and 5 sites on the River Yamuna found abundant presence of coliform and other pollutants.
- Only rainwater is supposed to flow in these drains, but the study found sewage waste and even industrial waste in some.
- A similar attempt made by DDA earlier, where a special task force was created to check dumping of waste in Yamuna, has not been successful.

8.3 Reforming Discoms

What is the issue?

- There is a steep fall in electricity demand with the onset of Covid-19.
- This has pushed power distribution companies, already in dire financial straits due to a tangle of structural factors, into a deeper mess.

What is the distress?

- Discoms' dues of over ₹ 1 lakh crore to power generators cannot be paid off in a hurry, unless their finances are knocked into a semblance of order.
- Realising that the country cannot afford a sputtering power sector, the Centre announced a relaxation in credit limits for discoms.

What is the announcement?

- Power Finance Corporation and Rural Electrification Corporation will extend **loans to discoms** to meet liabilities towards gencos.
- These loans will be given on a one-time basis, which will be over and above the working capital loan limit of 25% of last year's revenues.
- The contours of a rescue plan were drawn up in May, when the Finance Ministry announced a ₹ 90,000 crore liquidity package for discoms.
- However, the credit infusion should be accompanied by structural reforms.

What are the troubles of discoms?

- The financial troubles of discoms can be traced to the,
    1. High cost of power purchased by them,
    2. Erosion of their customer base with the rise in open access and captive power generation, and their operational inefficiencies.
- Thermal power costs have risen on account of poor fuel supply linkages and transportation costs from the mines to plants.
- Rapid capacity additions over the last decade, outpacing demand in recent years, contributed to lower capacity utilisation.
- This, in turn, has contributed to the transfer of higher per unit fixed costs to discoms.
- Improvement in battery storage technologies is a game-changer.
- With bulk users opting for open access and captive generation, the discoms' skewed cross-subsidisation model has come under stress.

What would the discoms do?

- Discoms should **refrain** from entering into **long-term contracts**, given the rapid technological advancements in renewable.
- This is because the prices of the renewable are more than competitive vis-a-vis coal-fired power.
- Discoms will feel the pressure to trim technical and commercial losses.
- Agriculture losses can be curtailed by shifting to grid-based solar power.
- As for their universal service obligation to provide cheap power, **direct benefit transfers** will help deal with liquidity issues.
- **Tariffs** should be recalibrated to encourage use during lean hours.
- While discoms should not play foul by resisting consumers' shift to open access, they should be allowed to charge more from consumers who shuttle between options.
- Even as cross-subsidy becomes unviable, tariff rationalisation should help them improve their finances and provide quality power to all.

8.4 InvITs of NHAI

Why in news?

Infrastructure Investment Trusts (InvITs) of the National Highways Authority of India (NHAI) has started meeting investor groups.

What is the InvIT issue?

- InvIT is meeting investors as it prepares to come up with its InvIT issue
- The issue will enable NHAI to monetise its completed NHs that have a toll collection track record of at least one year.
- The NHAI reserves the right to levy toll on identified highways.
- It will help the company raise funds for more road development across the country.

What are InvITs?

- In 2019, InvIT was established as a Trust by NHAI under the Indian Trust Act, 1882 and SEBI regulations.
- The Securities and Exchange Board of India (SEBI) notified the SEBI (InvITs) Regulations, 2014 for this purpose.
- The InvIT Trust was formed with the objective of investment primarily in infrastructure projects.
- The InvIT pools investment from various categories of investors.
- They invest them into completed and revenue-generating infrastructure projects, thereby creating returns for the investor.

What is the structure?

- They have a trustee, sponsors, investment manager and project manager.
- **Trustee** - Certified by SEBI, the trustee has the responsibility of inspecting the performance of an InvIT.
- **Sponsors** - They are promoters of the company that set up the InvIT.
- In case of Public-private partnership (PPP) projects, it refers to the infrastructure developer or a special purpose vehicle (SPV) holding the concession.
- **Investment manager** is entrusted with the task of supervising the assets and investments of the InvIT.

- **Project manager** is responsible for the execution of the project.

How does it work?

- The fund will be raised by monetising the completed NHs.
- The project SPV would distribute not less than 90% of net distributable cash flow to the trust in proportion of its holding in each of the SPV.
- Further, not less than 90% of the net distributable cash flow of the trust will get distributed to the unitholders.
- The unitholders will get the distributions at least once every six months.
- The fund can be invested in the project SPVs by way of an issue of debt.
- The trust can utilise it to repay their loans or even for prepayment of certain unsecured loans and advances availed by such project SPVs.

How many InvITs were formed so far?

- The Indian InvIT market is not yet mature.
- It has supported formation of 10 InvITs till date in roads, power transmission, gas transmission and telecom towers sectors.
- Of this, only two InvITs are listed on the stock exchange: IRB InvIT Fund and India Grid Trust.
- The listed are required to maintain a maximum-leverage ratio of 49%
- This can be increased to 70% subject to certain conditions, such as six continuous distributions to unit-holders and AAA-rating.
- With the significant amount of funding required in the infrastructure sector and a gap in availability of long-term funds, this structure helps close that gap by enabling fund raising from capital markets.

Why does NHAI need fund and how will it benefit the economy?

- At a time when private sector investment in the economy has declined, fund-raising by NHAI and spending on infrastructure will,
    1. Crowd-in private sector investment,
    2. Provide a fillip to the economy.
- So NHAI's InvIT offer is a way for the government to tap alternative sources of financing to boost public spending in the infrastructure sector.
- In 2017, the Centre launched its Bharatmala Pariyojana, for development of 24,800 km of roads at a total investment of Rs 5,35,000 crore.
- [Bharatmala Pariyojana - Highway development programme.]
- In order to **complete the projects**, NHAI needs adequate funds.
- One of the options is to monetise the completed NH assets and offer attractive schemes to private players to invest in construction of NHs.

How does it benefit the investor?

- A retail or even a large financial investors may not be typically able to invest in infrastructure projects such as roads, power, energy etc.
- InvITs enable these investors to buy a small portion of the units being sold by the fund depending upon their risk appetite.
- Given that such trusts comprise largely of completed and operational projects with positive cash flow, the risks are somewhat contained.

- The investors can benefit from the cash flow that gets distributed as well as in capital appreciate of the units.
- Unitholders benefit from favourable tax norms, including exemption on dividend income and no capital gains tax if units are held for more than three years.

8.5 Shimla-Mataur Highway

Why in news?

The Shimla-Mataur highway was declared unviable by the central government.

Where is the Shimla-Mataur highway?

- The Shimla-Mataur highway is one of Himachal Pradesh's primary national highways set for four-laning.
- It runs northwest from Shimla for around 223 kilometres.
- It passes through the districts of Solan, Bilaspur and Hamirpur before ending at the Mataur junction in Kangra district.

Why is it important?

- The highway **directly connects** the state capital Shimla to Kangra, the state's most populated district.
- Kangra is home to Himachal's second capital Dharamshala.
- Kangra, Bilaspur and Hamirpur in lower Himachal, primarily connected to Shimla via this highway.
- The highway facilitates **indirect linking** of Shimla with parts of Mandi, Kullu, Una and Chamba districts.
- In effect, it connects Shimla with 9 out of 12 districts in the state.
- It's important for **religious tourism** too, since it provides connectivity to major pilgrimage centres in lower Himachal.

What is the history of the road-widening project?

- In 2016, Union minister for road transport and highways announced that the highway would be four-laned.
- In addition, the NHAI was to build tunnels and bridges along the route and bypass some towns, to reduce the distance and travel-time.
- The road was to be widened in five different 'packages', or sections.
- The NHAI hired M/s Inter Continental Consultants and Technocrats, New Delhi, to prepare detailed project reports (DPRs) for this.
- Delays in the DPR process caused the High Court of Himachal Pradesh to intervene in the matter in 2017.
- In 2019, the HC directed NHAI and other agencies involved to ensure expeditious completion of works.

What is the status of the road-widening project?

- In his 2020 budget speech, Chief Minister Jai Ram Thakur mentioned the highway as a priority project for the state.
- The final DPR is now complete.
- The land acquisition process is underway.
- However, no construction/excavation work has begun yet.

When was it declared unviable?

- In July 2020, the Union ministry of road transport and highways wrote to NHAI regarding the unviability of 2,887 kms of highways in India.
- This included the Shimla-Mataur highway.

- The NHAI asked the ministry to transfer the development, maintenance and repair of the road to the state public works department.
- According to an NHAI official, the projected cost is Rs 10,000 crore.
- Of this, Rs 7,000 crore is the project cost and Rs 3,000 crore the land acquisition cost.
- The financial crisis caused by the Covid pandemic was one of the factors behind the project being declared unviable.

Is the four-laning cancelled?

- The ministry asked the NHAI to continue to repair, develop and maintain the road instead of handing it to the state.
- But, the state is committed towards the four-laning of this highway.
- It is raising this matter with the Centre regularly.

8.6 Railway Privatisation

Why in news?

The mega plan for privatisation of passenger trains was unveiled by the Railway Board a couple of months ago.

What is the plan?

- It involves privatisation of a total of 151 trains in 12 clusters, with a minimum of 16 coaches in each train running at 160 kmph.
- Eventually it will cover 109 routes, compared to the 9,000-plus passenger trains that had been time-tabled to run every day prior to the Covid-19 lock down.
- This may not be much, but it is a good beginning.

How will the bidding take place?

- Over 120 RFQ from 15 parties is an indicator of the project's popularity. The bidders are to be short-listed by November 2020 for the final round.
- The contracts are to be placed by April 2021, and the first lot of private train sets to arrive by April 2023.
- The operator may be allowed to import three trains in each of the 12 clusters while the rest are to be manufactured in India.
- The bidding is to be on a revenue-sharing basis; the one that pays the Railways the most, wins.
- However, a short history lesson, from British Rail, would be in order.

What is the history?

- During the Margaret-Thatcher era, the British Rail went for massive privatisation that proved an unmitigated disaster.
- Treating maintenance of infrastructure, rolling stock maintenance, and passenger and freight train operations, etc, as **separate activities** were all privatised as distinct business units.
- The scores of private entities were created for every possible activity of the British Rail.
- However, a few years after, all hell broke loose when a serious mishap took place at the Potter's Bar station involving human casualties.

What did the enquiry reveal?

- A statutory enquiry revealed that that the new company, called 'Network Rail', that now owned rail infrastructure had been cutting corners.

- This resulted in the mishap.
- There were stringent conditions for liability and compensation in case things went wrong.
- So, the first people to reach an accident site were lawyers who had to find what went wrong to establish the liability, and due compensation.

What did the report reveal?

- A public-interest report was released by the Centre for Research in Socio Cultural Change (CRESC), a think tank based in Manchester, the UK.
- The report pointed out that the actions like the public subsidies paid out to shareholders as dividends and Network Rail's unsustainable debt had negative consequences for physical infrastructure.
- The report pointed out that due to negative consequences, the railways will have to be bailed out by the public.
- At last, it had to be 'bailed out', and then taken over by the government.
- This will not be the case with the Indian Railways, as only a few private train operators (PTOs) are to be inducted, and rest of the system is not being privatised.

What needs to be done?

- The PTO is to introduce coaches or trains with technology superior to that of Indian Railways.
- So, upgrading the track to support running of trains at 160 kpmh from existing 120 kpmh will need to be carried out by IR on top priority.

What would be the role of the proposed regulator?

- The proposed private trains will be sharing track space with other passenger and freight trains, which could lead to disputes.
- For the private train to be **punctual**, it may have to be accorded priority at the cost of other trains, to avoid any penalty for being late.
- Anticipating a plethora of such problems that may arise in the PPP initiative, a 'regulator' is proposed to be created.
- With commissioning of the West and East Dedicated Freight Corridors, the private sector may invest in **freight wagons** as well and run them.
- This will be keeping the proposed regulator quite busy.

What could be learnt?

- The private investment should not end up with many rolling stock being purchased, and with no matching maintenance facility being created.
- The operator may simply walk away while banks or investors who would have financed the whole project left holding the baby!
- This was the case with the British Rail privatisation.
- Hopefully, the Indian Railways will learn from the pitfalls of the British Rail privatisation, and be able to carefully avoid them.

8.7 Aircraft (Amendment) Bill 2020

Why in news?

Rajya Sabha has passed the Aircraft (Amendment) Bill 2020.

What does the amendment seek to do?

- The bill will amend the **Aircraft Act of 1934**.
- It seeks to provide statutory status to the
    1. Directorate General of Civil Aviation (DGCA),
    2. Bureau of Civil Aviation Security (BCAS), and
    3. Aircraft Accidents Investigation Bureau (AAIB).
- It seeks to expand the role of the two regulators, DGCA and BCAS.

What will change when this Bill becomes law?

- The DGCA will be empowered to impose penalties for certain violations.
- It will increase the maximum penalty limit to Rs 1 crore from the existing Rs 10 lakh.
- It will allow the Ministry of Civil Aviation to review any order passed by the Director General of Civil Aviation and the Director General of Civil Aviation Security.
- The Ministry can direct them to rescind or modify such order.

Why are these amendments being made to the Aircraft Act?

- The Aircraft Act of 1934 was enacted to control the manufacture, possession, use, operation, sale, import and export of aircraft.
- It secures the safety of aircraft operations in India.
- It makes provisions for carrying out civil aviation operations as per standards, procedures and practices laid down by the International Civil Aviation Organisation (ICAO).
- From time to time, the government has made amendments to the Act to meet the evolving global and Indian aviation scenario.
- The various changes that needed to be made necessitated amendments to the Aircraft Act.

What was the trigger for these changes now?

- India, as a signatory, is subjected to **audits** by ICAO and the Federal Aviation Administration (FAA).
- The audits conducted by the ICAO in 2012 and 2015 indicated a need to amend the Aircraft Act,
    1. To give proper recognition to the regulators under the Act,
    2. To enhance the maximum quantum of fines,
    3. To empower the departmental officers to impose financial penalties on individuals or organisations involved in violations of the legal provisions and
    4. To include certain areas of air navigation services for rulemaking purposes under Section 5 of the Act.
- These are the triggers for proposal to amend the Aircraft Act of 1934.

How are the audits conducted?

- **ICAO** - The ICAO regularly conducts safety and security audits of all countries which are signatory to the Chicago Convention.
- These audits are done to ensure these countries are carrying out their safety and security oversight functions.
- These audits are conducted under its Universal Safety Oversight Audit Programme and the Universal Security Audit Programme.
- **FAA** - The FAA of the US also conducts safety audits of countries whose airlines operate to the US.
- These audits are conducted under its International Aviation Safety Assessment Programme.

8.8 A New Model of Urban development

Why in news?

At the **Bloomberg New Economy Forum**, PM called for reimagining of urban planning and development to make cities healthy and liveable after COVID-19.

Why the new urban planning is needed now?

- The fragile infrastructure in urban areas aided the virus spread quickly in cities.
- In the first hundred days of the pandemic, the top 10 cities affected by virus worldwide accounted for 15% of the total COVID cases.
- There was Rapid transmission in Mumbai, Delhi, Bengaluru and Chennai due to densification and inability to practice distancing norms.
- Whereas in Dharavi, which is one of the world's highest slum densities, experienced low viral impact due to screening and herd immunity.

What should be the new urban planning based on?

- Good, affordable housing is the necessary for a sustainable and healthy city.
- Unlike speculative housing investments, well-designed rental housing is key to protecting migrant labour and other less affluent sections from virus spread.
- Mumbai is estimated to have added only 5% of rental housing in new residential construction (1961-2000), and that too led by private funding.
- The Centre's **Affordable Rental Housing Complexes** scheme should focus on building new houses on the lines of the post-war reconstruction in Europe, Japan and South Korea by coordinating with states.
- The laws on air pollution, municipal solid waste management and water quality should be strictly enforced to make urban mobility comfortable.
- Cholera, plague and global flu pandemic a century ago led to change in sewerage, waste handling, social housing and health care which helped in controlling the disease.

8.9 Andhra Pradesh's Capital Conundrum

Why in news?

Andhra Pradesh Decentralisation and Inclusive Development of All Regions Bill, 2020, sets to replace earlier plan of building Amaravati as a capital to developing 3 capital cities.

What is 3 Capital Plan?

- The bill states that the State will have Visakhapatnam, Amaravati and Kurnool as the executive, legislative and judicial capitals of the State respectively.
- The plan is similar to that in South Africa.
- The Sribagh pact, which happened between **Rayalaseema and coastal Andhra in 1937,** decided that if high court is in coastal Andhra, capital should be in Rayalaseema
- K.C. Sivaramakrishnan (KCS) Committee has also made recommendations along similar lines
- Even Maharashtra has two capitals, **Mumbai** & **Nagpur**, with the latter being the winter capital of the state.

What are the benefits of the plan?

- It helps to promote Even development in the state as north-coastal Andhra and Rayalaseema districts are the backward compared to the central coastal districts.

- A secretariat in Vizag can help in the development of regions ***like Vizianagaram and Srikakulam*** which consists of tribal and rural areas and are the most backward regions of the state.
- It helps to promote decentralised governance to spatially de-concentrate executive power, driven by region-specific economic activities.
- Eg: KCS Committee recommends that for Vizag region's suitability, it should have government offices relevant to local economic potential, such as for ports, shipping, fisheries and industry.

What are the challenges in it?

- Running legislative business with most of the secretariat located 400 km away can lead to high logistical costs and inefficiencies.
- There is lack of well-developed infrastructural network linking the growth centres.
- Visakhapatnam, in spite of its excellent and natural advantages, is lacking in in infrastructure.
- It might unfold new problems as uncontrolled real estate interests can compromise the environmental interests.
- The recent environmental disasters, including the LG Polymers gas leak also expose the city's vulnerabilities.
- The bill also lacks appropriate details for the distributed development.

8.10 Power Pricing Reforms

Why in news?

The next set of power reforms is centring around amending the Electricity Act and/or the Tariff Policy proposed rather than the addressing of structural issues in power supply.

What are the structural issues in Power sector?

- There is surplus generating capacity-by March 2020, the installed capacity was 370.05 GW, but the electricity demand has never gone above 183 GW.
- Hence, states with more than 30-40% of installed capacity either backed down or shut down leading to 15-35% of total fixed cost to unscheduled electricity.
- Aggressive energy efficiency drive **(UJALA programme**) will reduce the power bill of consumers, but power demand decreases and adds to the fixed costs that utilities pay.
- Increasing renewables without retiring old and polluting coal-fired generators, long tenure of power procurement agreements, excess tied capacity are other such issues.

What are the concerns with respect to Tariff Policy?

- It aims to keep tariffs for all categories of consumers within the maximum range of 20% below or above the average cost of supply.
- An analysis by IEA finds that residential tariff on PPP basis in India is higher compared to Russia, China, the US, Indonesia, Canada, Korea, etc.
- Hence tariff hike on electricity will impact the household finance as cross-subsidies cannot be avoided at this time (creates price inflation especially in rural areas).
- States which are moving towards non-remunerative tariff fixation will lead to vicious circle of larger debt, unsustainable discoms & delegitimizion of regulatory assets.
- Subsidies or tariff compensation to discoms are as high as (15%) & it is increasing rapidly which is not in pace with cost of supply.

What is the need of the hour?

- A trade-off between sufficiency and affordability of power must be arrived.
- The tariffs should reflect the cost of supplying electricity.
- A robust system of DBT should be developed to reduce the financial burden of consumers and free riding, theft of power by unscrupulous consumer can also be addressed by it.
- All the cross-subsidies should go out in phased manner and efficiency of utilities should be increased.
- State regulators are duty-bound to safeguard consumer interests and to encourage competition in the sector through policy interventions and reforms to ensure 24×7 quality power at affordable prices.